

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 7059 PCB WMC 21-02 Corporate Income Tax

SPONSOR(S): Ways & Means Committee, Payne

TIED BILLS: **IDEN./SIM. BILLS:**

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
Orig. Comm.: Ways & Means Committee	15 Y, 0 N	Berg	Aldridge

SUMMARY ANALYSIS

Florida generally 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 bill adopts the IRC as of January 1, 2021, applicable retroactive to January 1, 2021, with four exceptions that prevent a recurring impact (negative or positive) on General Revenue.

First, the bill decouples from temporary federal provisions that provided for an increase in the allowable deduction of business interest expense from 30% to 50% of adjusted taxable income for 2019 and 2020, found in the Coronavirus Aid, Relief, and Economic Security Act (CARES Act).

Second, the bill decouples from temporary federal provisions in the Consolidated Appropriations Act, 2021 (enacted December 27, 2020) increasing from 50% to 100% the amount of meal expenses paid or incurred in 2021 or 2022 that are deductible.

Third, the bill decouples from the provisions in the CARES Act that adjust the depreciable life of certain qualified improvement property from 39 years to 15 years.

Fourth, the bill decouples from temporary federal provisions in the Consolidated Appropriations Act, 2021, that extended the ability for certain film productions to expense costs up to \$15m per year in the year incurred, through December 31, 2025.

The Revenue Estimating Conference has not estimated the potential revenue impacts of the bill. However, staff estimates that the bill has no recurring impact on General Revenue in FY 2021-22.

Staff estimates that the bill will have a -2.5 million cash impact on General Revenue in FY 2021-22 primarily from adopting the provisions in the CARES Act and the Consolidated Appropriations Act, 2021 that allow for an increase in deductions for charitable contributions made in 2020 and 2021.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Present Situation

Federal Tax Code Conformance

Florida generally levies a 5.5 percent tax¹ on the taxable income of corporations and financial institutions doing business in Florida.² 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.³ 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 IRC as it exists on January 1.⁴ By doing this, Florida adopts any changes to the IRC related to determining federal taxable income that were made during the previous year. However, a state may choose to “decouple” from particular changes made to the IRC in the prior year, and instead specify its own treatment of the issue, or allow the previous IRC treatment to continue for Florida tax purposes.

The Coronavirus Aid, Relief, and Economic Security (CARES) Act

On March 27, 2020, the federal government passed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act).⁵ The CARES Act made a number of temporary and permanent changes to individual and corporate income tax provisions, in addition to significant changes in other areas (e.g. unemployment benefits). Some of the significant changes to the Internal Revenue Code include:

- A temporary increase in the allowable deduction for business interest expenses, from 30% to 50%, for 2019 and 2020;⁶
- A retroactive amendment to Internal Revenue Code provisions first enacted in the Tax Cuts and Jobs Act of 2017 (TCJA) that required certain qualified improvement property costs to be depreciated over 39 years instead of 15 years;⁷
- A temporary increase in net operating loss provisions, allowing 2018-2020 NOLs to offset 100% of income when used (instead of 80%), and allowing those NOLs to be carried back five years;⁸ and
- A temporary increase in the allowable charitable deduction, from 10% to 25% of a corporate taxpayer’s taxable income.

Business Interest Expense Deduction

The business interest expense (BIE) provisions of the Internal Revenue Code provide a tax deduction for interest expenses or other borrowing costs incurred in a trade or business or in the production of rental or royalty income.⁹ The deduction is generally applied in the year the expenses are paid or

¹ The tax rate was adjusted downward to 4.458 percent pursuant to s. 220.1105, F.S., for taxable years beginning on or after January 1, 2019. Pursuant to s. 220.1105(5), F.S., the rate is scheduled to return to 5.5 percent for taxable years beginning on or after January 1, 2022.

² s. 220.11(2), F.S.

³ s. 220.12, F.S.

⁴ ss. 220.03(1)(n) and (2)(c), F.S.

⁵ Public Law No. 116-136.

⁶ Section 2306, Public Law No. 116-136. This provision also allows the 2020 50% limitation to be calculated based on 2019 income, which may allow for a larger deduction than would otherwise have been available.

⁷ Section 2307, Public Law No. 116-136.

⁸ Section 2303, Public Law No. 116-136. Note that the state impact from these changes will be very different from the federal impact, as Florida disallows all carryback of NOLs at the state level. This provision may lead to large federal refunds, but the impact on Florida is expected to be minimal.

⁹ 26 U.S.C. s. 163.

accrued, depending on the taxpayer's method of accounting. Florida currently conforms to the Internal Revenue Code on the BIE deduction and does not decouple from any provision.

Before the enactment of the TCJA, taxpayers could generally fully deduct their BIE, subject to some restrictions and exceptions. The TCJA limited, except for certain taxpayers¹⁰, the BIE deduction for taxable years beginning after 2017 to the sum of the taxpayer's business interest income for the taxable year, 30 percent of the taxpayer's adjusted taxable income for the taxable year, and the taxpayer's floor plan financing interest for the taxable year.¹¹ The amount of business interest not allowed as a deduction because of this limitation generally may be carried forward indefinitely.¹² The CARES Act has temporarily increased this limit for taxable years beginning in 2019 and 2020, raising the 30 percent limit on a taxpayer's adjusted taxable income in the above formula to 50 percent.¹³

Depreciation of Qualified Improvement Property

Generally, the Internal Revenue Code allows a depreciation deduction from taxable income, which is a reasonable allowance for the exhaustion and wear and tear (including a reasonable allowance for obsolescence) of property used in a trade or business or property held for the production of income.¹⁴ An allowance (deduction) is set aside each taxable year in accordance with a reasonably consistent plan, starting when the property is placed in service.¹⁵ The aggregate amount of the allowances plus the salvage value, at the end of the estimated useful life of the property, should equal the cost or other specified basis of the property.¹⁶ Over time, the Internal Revenue Code has adopted different systems for computing depreciation. The current system, the Modified Accelerated Cost Recovery System (MACRS), applies to most tangible property generally placed in service after 1986.¹⁷ Under MACRS, the cost of eligible property is recovered over a 3-, 5-, 7-, 10-, 15-, 20-, 27.5-, 31.5-, or 39-year period, depending on the type of property, by applying statutory recovery methods and conventions.

Starting in 2001 with the federal Job Creation and Worker Assistance Act of 2002, Congress implemented, reinstated, and expanded a "bonus depreciation" allowance for qualifying property, which was created to spur increased business investment during periods of negative or sluggish economic growth by lowering the cost of capital for investment in certain assets.¹⁸ Bonus depreciation allows a taxpayer to deduct up to 100 percent of the cost of the property in the taxable year it is placed in service. The bonus depreciation provision has been extended or expanded 10 times since 2002, including by the TCJA.¹⁹ The TCJA generally increased the bonus rate for property acquired and placed in service after September 27, 2017, to 100 percent for property placed in service in 2017 through 2022, 80 percent in 2023, 60 percent in 2024, 40 percent in 2025, and 20 percent in 2026.²⁰

The TCJA also made changes to the depreciation deduction of certain improvements that leaseholders or owners make to the interior space of nonresidential buildings. Improvement property can take many forms, with some examples being: installing new lighting and carpet in a leased office, adding new woodwork and windows to the dining room of a restaurant, and painting the walls and upgrading the sound system of a retail store.²¹ Before the TCJA, the Internal Revenue Code contained four categories

¹⁰ Taxpayers with average annual gross receipts in the prior three taxable years of \$25 million or less are exempted from the limitation, as well as certain trades or businesses. *See* 26 U.S.C. s. 163(j)(3) and (7).

¹¹ 26 U.S.C. s. 163(j).

¹² 26 U.S.C. s. 163(j)(2).

¹³ 26 U.S.C. s. 163(j)(10).

¹⁴ 26 U.S.C. s. 167(a).

¹⁵ 26 C.F.R. ss. 1.167(a)-1(a), 1.167(a)-10(b).

¹⁶ 26 C.F.R. s. 1.167(a)-1(a).

¹⁷ 26 U.S.C. s. 168; 26 C.F.R. 1.168(a)-1, *et seq.*

¹⁸ 26 U.S.C. s. 168(k). *See* Congressional Research Service, *The Section 179 and Section 168(k) Expensing Allowances: Current Law and Economic Effects* (Updated May 1, 2018), available at <https://crsreports.congress.gov/product/pdf/RL/RL31852> (last visited April 11, 2021).

¹⁹ *Id.* at 10.

²⁰ 26 U.S.C. s. 168(k)(6)(A).

²¹ *See* Congressional Research Service, *Tax Depreciation of Qualified Improvement Property: Current Status and Legislative History* (updated June 24, 2020), available at <https://crsreports.congress.gov/product/pdf/IF/IF11187> (last visited April 14, 2021).

of such improvement property, each with different criteria and cost recovery requirements.²² Three of the four categories had a 15-year cost recovery period, and the other was eligible for bonus depreciation even though it had a 39-year cost recovery period. The TCJA combined the four categories into a single category called qualified improvement property (QIP).²³

The TCJA left QIP off the list of assets eligible for a 15-year cost recovery period under the MACRS.²⁴ As a result, the cost of all QIP had to be recovered over 39 years under MACRS (or 40 years under an alternative depreciation system), and was ineligible for the bonus depreciation allowance because such improvement property must have a recovery period of 20 years or less to qualify for bonus depreciation.²⁵ The CARES Act retroactively designated QIP as 15-year property under the MACRS and 20-year property under the alternative depreciation system, to take effect as if included in the TCJA.²⁶

Florida has decoupled from federal bonus depreciation since 2008.²⁷ Since 2009, Florida requires a taxpayer to add back to its taxable income the full amount deducted for bonus depreciation for federal purposes and then apply a straight-line seven-year depreciation schedule beginning with the year of the addback.²⁸ The schedule applies notwithstanding any sale or disposition of the property that is the subject of the adjustments and regardless of whether such property remains in service in the hands of the taxpayer.²⁹

Net Operating Loss Deduction

The net operating loss (NOL) provisions of the Internal Revenue Code provide a tax deduction for most taxpayers whose deductible expenses for a taxable year exceed their gross income, subject to certain adjustments.³⁰ When a firm has a loss (i.e., an NOL), its federal income taxes are not reduced immediately beyond zero; rather, the business owes no income tax in that taxable year and its loss is carried to other years.³¹ An NOL is “carried back” when applied to taxable years before the loss year and “carried over” or “carried forward” when applied to taxable years after the loss year. A carryback of losses yields immediate tax reductions in the form of a refund or credit, while a carryforward reduces future tax liabilities.³² The Internal Revenue Code requires that NOLs be applied starting with the earliest taxable year to which the loss may be carried.³³ Generally, Florida currently follows the Internal Revenue Code with respect to the computation and handling of an NOL for Florida corporate income tax purposes, except that for Florida purposes, an NOL may be carried forward only and may not be carried back to taxable years before the loss year.³⁴

Before the enactment of the TCJA, a taxpayer could, for federal income tax purposes, use the aggregate amount of NOLs carried back or carried forward from other loss years to fully offset its taxable income for a taxable year and owe no income tax for that year.³⁵ The TCJA limited the percentage of taxable income that NOLs generated in taxable years after 2017 could offset to 80 percent of the taxable income for a taxable year.³⁶ The CARES Act temporarily suspends this limitation

²² Qualified leasehold improvement property, qualified restaurant improvement property, qualified retail improvement property, and qualified improvement property. *See id.*

²³ *Id.*

²⁴ *Supra* note 39.

²⁵ *Id.*

²⁶ Pub. L. No. 116-136, s. 2307(b) (2020).

²⁷ Ch. 2008-206, ss. 1-2, Laws of Fla.

²⁸ Section 220.13(1)(e)1., F.S.; ch. 2009-18, s. 2, Laws of Fla.

²⁹ Section 220.13(1)(e)1., F.S.

³⁰ 26 U.S.C. s. 172.

³¹ *See* Congressional Research Service, *Tax Treatment of Net Operating Losses (NOLs) in the Coronavirus Aid, Relief, and Economic Security (CARES) Act* (Updated Oct. 6, 2020), available at <https://crsreports.congress.gov/product/pdf/IN/IN11296> (last visited April 14, 2021).

³² *Id.*

³³ 26 U.S.C. s. 172(b)(2).

³⁴ Section 220.13(1)(b)1., F.S., and Fla. Admin. Code R. 12C-1.013(15)(a).

³⁵ 26 U.S.C. s. 172(a) (2016).

³⁶ 26 U.S.C. s. 172(a) (2018).

for taxable years beginning in 2018, 2019, and 2020, allowing a taxpayer to use NOLs generated in those years to fully offset taxable income when used.³⁷

The TCJA generally prohibited the carryback of NOLs generated in taxable years after 2017 while allowing such NOLs to be carried forward indefinitely, a change from a general 2-year carryback period and a 20-year carryover period.³⁸ The CARES Act temporarily lifted the carryback restriction, providing a 5-year carryback period for NOLs generated in taxable years 2018, 2019, and 2020. However, the carryback change does not affect Florida because, as described above, Florida has decoupled from NOL carryback provisions and does not allow NOLs to be carried back.

Consolidated Appropriations Act, 2021

On December 27, 2020, the federal government passed the Consolidated Appropriations Act, 2021 (CAA).³⁹ The annual appropriations act set forth the budget for the federal government, but also included additional tax relief provisions for individuals and businesses. The primary change in the CAA to the Internal Revenue Code is a temporary increase in the allowable deduction for corporate meal expenses. For meal expenses paid or incurred in 2021 or 2022, 100% of otherwise allowable expenses can be deducted, instead of the standard 50% deduction for federal income tax purposes.⁴⁰

Other changes were made in the CAA to the Internal Revenue Code which appear to have limited or no impact on Florida taxpayers. These include tax extenders and other miscellaneous provisions.

Tax Extenders and Miscellaneous Provisions

The CAA extended or modified a number of tax provisions relating to the federal income tax for corporations, including:

Providing 5-year extensions for:

- The “look-thru” treatment of dividends, interest, rents, and royalties received or accrued from related controlled foreign corporations.⁴¹
- The 7-year recovery period for motorsports entertainment complexes.⁴²
- Special expensing rules for certain film, television, and live theatrical productions, which allows a taxpayer to expense the first \$15 million of production costs for qualified film and television productions and live theatrical productions (or \$20 million for productions in low-income communities or distressed areas).⁴³
- Empowerment zone designations under s. 1391(d) of the Internal Revenue Code.⁴⁴

Providing a 1-year extension for:

- The classification of certain race horses as 3-year property.⁴⁵
- Accelerated depreciation for business property on Indian reservations.⁴⁶
- The increased limitation on deductions for charitable contributions by corporations under the CARES Act.⁴⁷ The increased limitation applies for 2021.

The CAA also extended or modified a number of federal tax credits affecting the federal corporate income tax.⁴⁸

³⁷ 26 U.S.C. s. 172(a) (2021).

³⁸ 26 U.S.C. s. 172(b)(1) (2018).

³⁹ Public Law No. 116-260.

⁴⁰ Section 210, Public Law No. 116-136.

⁴¹ Pub. L. 116-260, Division EE, s. 111 (2020).

⁴² Pub. L. 116-260, Division EE, s. 115 (2020).

⁴³ Pub. L. 116-260, Division EE, s. 116 (2020); 26 U.S.C. s. 181. The Revenue Estimating Conference’s estimated fiscal impact for adopting this extension is described in Section V below.

⁴⁴ Pub. L. 116-260, Division EE, s. 118 (2020).

⁴⁵ Pub. L. 116-260, Division EE, s. 137 (2020).

⁴⁶ Pub. L. 116-260, Division EE, s. 138 (2020).

⁴⁷ Pub. L. 116-260, Division EE, s. 213 (2020).

Proposed Changes

The bill updates the Florida corporate income tax code by adopting the Internal Revenue Code as in effect on January 1, 2021, with four exceptions. First, the bill decouples from temporary federal provisions that provided for an increase in the allowable deduction of business interest expense from 30% to 50% of adjusted taxable income for 2019 and 2020, found in the CARES Act. Second, the bill decouples from temporary federal provisions in the Consolidated Appropriations Act, 2021 increasing from 50% to 100% the amount of meal expenses paid or incurred in 2021 or 2022 that are deductible. Third, the bill decouples from temporary federal provisions in the CAA that extend certain expensing rules for film, television, and live theatrical productions through 2025. Fourth, the bill decouples from the provisions in the CARES Act that adjust the depreciable life of certain qualified improvement property from 39 years to 15 years.

By adopting the Internal Revenue Code as in effect January 1, 2021, the following provisions, among others, will be adopted for Florida corporate income tax purposes:

- The bill adopts the CARES Act's suspension of the 80 percent NOL limitation, meaning that for NOLs created in taxable years beginning in 2018, 2019, and 2020, a Florida taxpayer may use those NOLs to fully offset its taxable income, rather than up to 80 percent.
- The bill adopts the CARES Act's increased limitation on the charitable contribution deduction for 2020, and the CAA's extension of that increase for 2021, in that any increased charitable contribution deduction taken by a taxpayer for federal income tax purposes would flow through to Florida when calculating its Florida net income.

This bill is effective upon becoming law and, except as otherwise provided, applies retroactively to January 1, 2021.

B. SECTION DIRECTORY:

Section 1: Amends s. 220.03, F.S., to adopt the 2021 Internal Revenue Code.

Section 2: Makes changes to s. 220.03, F.S., retroactive to January 1, 2021.

Section 3: Amends s. 220.13, F.S., to decouple from the federal treatment of several issues.

Section 4: Provides emergency rulemaking to the Department of Revenue.

Section 5: Provides an effective date of upon becoming a law.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

The Revenue Estimating Conference has not estimated the potential revenue impacts of the bill. However, staff estimates that the bill has no recurring impact on General Revenue in FY 2021-22. Staff estimates that the bill will have a -2.5 million cash impact on General Revenue in FY 2021-22.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

⁴⁸ See Pub. L. 116-260, Division EE, ss. 102, 105, 112, 113, 119, 121, 131, 132, 135, 136, 139, 140, 142, 143, 144, 145, 203, 204, and 305 (2020).

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:

Not applicable.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES