

REVENUE ESTIMATING CONFERENCE

Tax: Corporate Income Tax

Issue: Corporate Add-back

Bill Number(s):

Entire Bill

Partial Bill:

Sponsor(s):

Month/Year Impact Begins: July 2013

Date of Analysis: 3/20/2013

Section 1: Narrative

- a. **Current Law:** 220.13 generally defines "Adjusted federal income," meaning an amount equal to the taxpayer's taxable income as defined in subsection (2), or such taxable income of more than one tax payer as provided in s. 220.131, for the taxable year.

220.15: Except as provided in ss. 220.151, 220.152, and 220.153, adjusted federal income as defined in s. 220.13 shall be apportioned to this state by taxpayers doing business within and without this state by multiplying it by an apportionment fraction composed of a sales factor representing 50 percent of the fraction, a property factor representing 25 percent of the fraction, and a payroll factor representing 25 percent of the fraction

- b. **Proposed Change:**

Section 1:

Creates (3) under 220.13: The restrictions in this subsection apply with respect to the deductibility of certain intangible expenses, interest expenses, and management fees involving a related entity.

- (a) As used in this subsection, the term:

1. "Related entity" means any artificial entity that would be a member of the taxpayer's affiliated group under s. 1504 of the Internal Revenue Code during all or any portion of the taxable year, except using an ownership percentage of 50 percent rather than 80 percent. A related entity includes any entity, other than a natural person, which would be included in the affiliated group based upon a 50 percent ownership percentage if it were organized as a corporation.
2. "Intangible expenses" means the following described amounts to the extent these amounts are allowed as deductions in determining federal taxable income under the Internal Revenue Code before the application of any net operating loss deduction and special deductions for the taxable year:
 - a. Expenses, losses, and costs directly or indirectly for, related to, or in association with the acquisition, use, maintenance, management, ownership, sale, exchange, or any other disposition of intangible property.
 - b. Royalty, patent, technical, trademark, and copyright fees;
 - c. Licensing fees; or
 - d. Other substantially similar expenses and costs, including, but not limited to, interest and losses from factoring transactions.
3. "Intangible property" means patents, patent applications, trade names, trademarks, service marks, copyrights, trade secrets, and substantially similar types of intangible assets.
4. "Interest expenses" means amounts that are allowed as deductions under s. 163 of the Internal Revenue Code in determining federal taxable income before the application of any net operating loss deductions and special deductions for the taxable year.
5. "Management fees" means expenses and costs paid for services, including, but not limited to, management overhead, management supervision, accounts receivable and payable, employee benefit plans, insurance, legal, payroll, data processing, purchasing, tax, financial and securities, billing, accounting, reporting and compliance services, or similar services, only to the extent that the amounts are allowed as a deduction or cost in determining taxable net income under the Internal Revenue Code before the application of any net operating loss deduction and special deductions for the taxable year.
6. "Recipient" means a related entity that is paid an item of income that corresponds to an intangible expense, interest expense, or management fee.

- (b) Except as provided in paragraph (c), in determining its adjusted federal income under this section and s. 220.131, a corporation subject to tax shall add to its taxable income intangible expenses, interest expenses, and management fees that are paid, accrued, or incurred directly or indirectly with one or more related entities. For income received

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from a pass-through entity or a disregarded entity, the corporation is deemed to have received its share of both the income and expenses of the pass-through entity or disregarded entity for purposes of this subsection.

- (c) Except as provided in paragraph (d), the addition of intangible expenses, interest expenses, and management fees otherwise required in a taxable year under this subsection for a specific related entity transaction is not required if:
1. The taxpayer and the recipient are both included in the same Florida consolidated tax return filed under s. 220.131 for the taxable year;
 2. The taxpayer and the executive director or his or her designee agree in writing to alternative computations or adjustments. The executive director or his or her designee may approve such agreement only if the taxpayer has clearly established to the satisfaction of the executive director or his or her designee that the disallowance of the deduction is unreasonable and that the proposed alternative method of determining the measure of the tax accurately reflects the activity, business, income, and capital of the taxpayers within this state. The agreement must be signed by the executive director or his or her designee and may not exceed 4 years;
 3. The taxpayer makes a disclosure on its return and establishes by clear and convincing evidence that:
 - a. The recipient was subject to an income tax or franchise tax measured in whole or part by net income in its state or country of commercial domicile. If the recipient is a foreign corporation, the foreign nation must have in force a comprehensive income tax treaty with the United States;
 - b. The tax base for such tax included the intangible expense, management fee, or interest expense paid, accrued, or incurred by the taxpayer;
 - c. The aggregate effective tax rate applied is no less than 5.5 percent;
 - d. The transaction did not have Florida tax avoidance as a principle purpose;
 - e. The recipient regularly engages in the same business with third parties; and
 - f. The transaction was made at a commercially reasonable rate and at arm's length terms similar to those with third parties; or
 4. The taxpayer makes a disclosure on its return and establishes by clear and convincing evidence that:
 - a. The related entity, during the same taxable year, directly or indirectly paid, received, or incurred the amount of the obligation to or from a person or entity that is not a related entity;
 - b. The transaction was done for a valid business purpose;
 - c. The payments are limited to a reimbursement of the amounts paid to a person or entity that is not a related party; and
 - d. The unrelated entity regularly engages in the same business with third parties on a substantial basis.
- (d) The exceptions described in subparagraphs (c) 3. and 4. do not apply:
1. To interest paid by a taxpayer in connection with a debt incurred to acquire the taxpayer's or a related entity's assets or stock in a transaction referenced in s. 368 of the Internal Revenue Code. For purposes of this paragraph, acquisition interest paid by a taxpayer to a person or entity that is not a related entity shall be treated as if made to a related entity;
 2. To intangible property acquired directly or indirectly from the taxpayer or from a related entity;
 3. If the related entity is primarily engaged in managing, acquiring, or maintaining intangible property or related party financing and a primary purpose of the transaction was the avoidance of Florida tax; or
 4. In those instances where the taxpayer files with the related entity or the related entity files with another related entity an income tax return or report where such return or report is due because of the imposition of a tax on or measured by income, and where such income tax return or report results in the elimination of the tax effects from transactions directly or indirectly between the taxpayer and the related member.
- (e) To the extent that a taxpayer is required to make an adjustment under paragraphs (b) and (c) for a specific related entity transaction, the corresponding related entity shall make a corresponding subtraction to its taxable income, if subject to tax in Florida.
- (f) The amount of a taxpayer's net operating loss carryover from tax years ending prior to December 31, 2013, to a tax year ending on or after December 31, 2013, shall be adjusted to account for the add back of intangible expenses, interest expenses, and management fees under this subsection. Under no circumstances may this recalculation increase the amount of a net operating loss carryover or deduction.
- (g) This subsection does not require a taxpayer to add to its Florida net income more than once any amount of interest expenses, intangible expenses, and management fees that the taxpayer pays, accrues, or incurs to a related entity.

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- (h) This subsection does not allow any item to be deducted more than once, does not allow a deduction for any item that is excluded from income, and does not allow any item to be included in the Florida taxable income of more than one taxpayer.
- (i) This subsection does not limit or negate the executive director's authority to make adjustments under s. 220.131(2), s. 220.44, or s. 220.152.
- (j) Each taxpayer shall provide the following information to the department along with its tax return regarding each related entity transaction:
 - a. The name of the recipient;
 - b. The state or country of domicile of the recipient;
 - c. The amount paid to the recipient; and
 - d. A complete description of the payment made to the recipient.
- (k) Failure to add back an amount paid directly or indirectly to a related party or failure to provide complete information with the tax return is evidence of negligence within the meaning of s. 220.803(1).

Section 2: Paragraph (a) of subsection (5) of section 220.15, F.S., as well as paragraph (d) of that subsection.

(a) Income from the sale, assignment, or licensing of intangible property is also included in the term.

(d) Sales that are not attributable or assignable to any taxing jurisdiction and sales that are attributable or assignable to jurisdictions where the taxpayer is not subject to an income tax, or where the jurisdiction does not impose and income tax, are eliminated from both the numerator and denominator of the sales factor.

Section 3: Effective date July 1, 2013.

Section 2: Description of Data and Sources

Phone conversation – Virginia Department of Taxation

Section 3: Methodology (Include Assumptions and Attach Details)

Using information obtained via phone conversation with the Virginia Department of Taxation, our starting point is Virginia’s add back collections in relation to their total corporate income tax collections. These two figures are divided by Virginia’s corporate income tax rate of 6 percent, to derive the base. Using the Virginia add back base’s proportion of the total corporate tax base, we derive the potential base impact to the corporate income tax base for Florida. The respective impacts to Florida’s corporate tax base are then multiplied by the corporate income tax rate of 5.5 percent. Virginia’s law captures royalties and the associated interest, therefore an additional piece accounting for management fees and associated interest, is layered on. The high estimate assumes a 5.5 plus an additional 5 percent increase for management fees and interest, is added to the corporate tax base. The middle estimate assumes a 4.9 plus an additional 4.5 percent increase for management fees and interest, is added to the corporate tax base. The low estimate assumes a 3.1 plus an additional 2.5 percent increase for management fees and interest, is added to the corporate tax base.

Alternatively, various other states CIT collections were examined at a per capita level, as well as a function of gross state product and personal income. Based on other states, there seems to be some capacity for Florida to increase its per capita dollar amount, or ratio of CIT to GSP and personal income. Assumes the change in law applies to tax years beginning on or after January 1, 2013.

Section 4: Proposed Fiscal Impact

	High		Middle		Low	
	Cash	Recurring	Cash	Recurring	Cash	Recurring
2013-14			\$88.8m	\$64.0m		
2014-15			\$67.0m	\$67.0m		
2015-16			\$68.6m	\$68.6m		
2016-17			\$67.6m	\$67.6m		
2017-18			\$67.1m	\$67.1m		

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List of affected Trust Funds: General Revenue

Section 5: Consensus Estimate (Adopted:04/02/2013) The conference adopted the proposed estimate with the assumption that the effective date would be for tax years on or after January 1, 2013.

	GR		Trust		Local/Other		Total	
	Cash	Recurring	Cash	Recurring	Cash	Recurring	Cash	Recurring
2013-14	88.8	64.0	0.0	0.0	0.0	0.0	88.8	64.0
2014-15	67.0	67.0	0.0	0.0	0.0	0.0	67.0	67.0
2015-16	68.6	68.6	0.0	0.0	0.0	0.0	68.6	68.6
2016-17	67.6	67.6	0.0	0.0	0.0	0.0	67.6	67.6
2017-18	67.1	67.1	0.0	0.0	0.0	0.0	67.1	67.1

	A	B	C	D	E	F	G	H	I
1									
2									
3			2009-10	2010-11	2011-12				
4		Virginia Addback**	\$25.0	\$40.0	\$45.0	<i>**Captures royalties and associated interest</i>			
5		CIT Receipts	\$800.0	\$810.0	\$815.0				
6									
7		VA CIT Rate	6.0%						
8									
9		VA Addback (base)	\$416.67	\$666.7	\$750.0				
10			3.1%	4.9%	5.5%				
11		VA CIT (base)	\$13,333.3	\$13,500.0	\$13,583.3				
12									
13									
14			2013-14	2014-15	2015-16	2016-17	2017-18		
15		FL CIT Receipts	\$2,284.7	\$2,391.7	\$2,451.7	\$2,414.1	\$2,397.2		
16		Tax Base (Receipts/0.055)	\$41,540.0	\$43,485.5	\$44,576.4	\$43,892.7	\$43,585.5		
17									
18	High	VA Addback (5.5%)	\$2,284.7	\$2,391.7	\$2,451.7	\$2,414.1	\$2,397.2		
19		MGMT Fees, interest (5%)	\$2,077.0	\$2,174.3	\$2,228.8	\$2,194.6	\$2,179.3		
20		subtotal	\$4,361.7	\$4,566.0	\$4,680.5	\$4,608.7	\$4,576.5		
21									
22	Middle	VA Addback (4.9%)	\$2,035.5	\$2,130.8	\$2,184.2	\$2,150.7	\$2,135.7		
23		MGMT Fees, interest (4.5%)	\$1,869.3	\$1,956.8	\$2,005.9	\$1,975.2	\$1,961.3		
24		subtotal	\$3,904.8	\$4,087.6	\$4,190.2	\$4,125.9	\$4,097.0		
25									
26	Low	VA Addback (3.1%)	\$1,287.7	\$1,348.0	\$1,381.9	\$1,360.7	\$1,351.1		
27		MGMT Fees, interest (2.5%)	\$1,038.5	\$1,087.1	\$1,114.4	\$1,097.3	\$1,089.6		
28		subtotal	\$2,326.2	\$2,435.2	\$2,496.3	\$2,458.0	\$2,440.8		
29									
30									
31		High Impact to CIT Receipts	\$125.7	\$131.5	\$134.8	\$132.8	\$131.8		
32			\$114.2	\$119.6	\$122.6	\$120.7	\$119.9		
33									
34		Middle Impact to CIT Receipts	\$112.0	\$117.2	\$120.1	\$118.3	\$117.5		
35			\$102.8	\$107.6	\$110.3	\$108.6	\$107.9		
36									
37		Low Impact to CIT Receipts	\$70.8	\$74.1	\$76.0	\$74.8	\$74.3		
38			\$57.1	\$59.8	\$61.3	\$60.4	\$59.9		
39									
40		High Impact to CIT Receipts	\$239.9	\$251.1	\$257.4	\$253.5	\$251.7		
41		Middle Impact to CIT Receipts	\$214.8	\$224.8	\$230.5	\$226.9	\$225.3		
42		Low Impact to CIT Receipts	\$127.9	\$133.9	\$137.3	\$135.2	\$134.2		
43									
44				High	Middle	Low			
45		2013-14	\$239.9	\$214.8	\$127.9				
46		2014-15	\$251.1	\$224.8	\$133.9				
47		2015-16	\$257.4	\$230.5	\$137.3				
48		2016-17	\$253.5	\$226.9	\$135.2				
49		2017-18	\$251.7	\$225.3	\$134.2				

	A	B	C	D	E	F	G	H	I	J	K
1											
2											
3					VALUE OF PERCENTAGE POINT						
4	Population	GSP (\$m)	Personal Inc		Total	Per	per \$1m	per \$1m			
5					Collection	Capita	GSP	Pers Inc			
6	FL	18,801	\$ 754,255	\$ 755,357,550	\$ 339,976,364	18.1		0.45		0.45	
7	NY	19,378	\$ 1,157,969	\$ 995,184,676	\$ 403,513,892	33.0	14.9	0.55	0.10	0.63	0.18
8	CA	37,254	\$ 1,958,904	\$ 1,645,138,372	\$ 1,087,510,633	29.2	11.1	0.56	0.10	0.66	0.21
9											
10											
11					Increase per capita	\$	1.00				
12					Increase of 1% in collections	\$	18,801,310				
13					Potential Impact	\$	103,407,205				
14											
15					Increase per \$1m GSP		0.01				
16					Increase of 1% in collections	\$	7,542,550				
17					Potential Impact	\$	41,484,025				
18											
19					Increase per \$1m Pers Inc		0.01				
20					Increase of 1% in collections	\$	7,553,576				
21					Potential Impact	\$	41,544,665				
22											
23											
24											
25											
26	Additional information: Certain information obtained from audits of out of state companies w/										
27	royalty income, with some amount originating in Florida: data from 70 audits										
28	indicated an annual tax liability of \$13.5 m for those entities										