

Special Session is Needed to Clarify Corporate Income Tax Law

Legislature Must Act Immediately to Avoid Potential Loss of Jobs and Further Harm to Florida's Economy

Summary

- The 2008 Florida Legislature passed HB 5065, which did not extend the corporate income tax relief provisions (a 50% bonus depreciation deduction and an additional expense allowance) of the federal economic stimulus package to Florida taxpayers in order to avoid the resulting loss of state tax revenue in the 2008-09 budget year.
- This measure was intended to be revenue neutral. Taxpayers could not apply the federal tax breaks to their state taxes, but it was not intended for them to lose their normal depreciation. However, it is now apparent that HB 5065 was not correctly drafted and **the result is some severe and unintended consequences.**
- The way the law is interpreted by the Florida Department of Revenue, **if taxpayers elect to take the bonus depreciation on their federal taxes, they will lose 50 percent of their depreciation deduction from their state taxes permanently.** Businesses will also lose state deductions if they choose to take the additional expense allowances. Florida would be the only state to permanently deny these deductions.
- Taxpayers are now in a no-win situation, where their choices are: 1) to not take advantage of the federal tax breaks; or 2) to face a state tax increase.
- This issue must be remedied now. On December 15, 2008, many corporate taxpayers must make their estimated federal income tax payments. If the law is not clarified by this date, many **taxpayers will have no choice but to elect not to take advantage of the federal economic stimulus provisions.** Other cash-strapped companies would be faced with increased estimated state tax payments and uncertainty would be injected into the financial statement process. All these impacts are especially undesirable for our state in this current economy.
- Not fixing this now will blunt the benefits of the federal stimulus package at a time when these benefits are needed to stimulate capital investment and create jobs in Florida. **Changing the law to reflect what the Legislature intended will not reduce estimated state revenues.**
- **Florida TaxWatch recommends that the Governor and/or the Speaker and President call a special session of the Legislature in conjunction with the organizational session scheduled for November 18, 2008, to correct this problem and to clarify that HB 5065 was not intended to result in a loss of state taxpayers' depreciation deductions.**

Background

During the 2008 General Session, the Florida Legislature passed what is normally a routine corporate income tax bill. However, provisions in that bill disallowed the application of some recently enacted federal corporate income taxes changes to state taxes. These provisions were intended to be revenue-neutral to state coffers and Florida taxpayers. However, it now appears that if Florida businesses choose to take advantage of the federal tax breaks, they will be subject to a major state tax increase. This was not the intent of the legislation.

Every year, the Legislature passes a “piggyback” bill that conforms Florida’s corporate income tax code to the federal code by picking up annual changes made by Congress. Florida TaxWatch supports this annual bill, which makes tax compliance less burdensome for businesses and administration easier for the state. Without the bill, businesses would have to keep two sets of books and track two different tax systems. Piggybacking also allows for better auditing by the state, which depends heavily on federal audits.

The 2008 Florida piggyback legislation (HB 5065) was a little different this year because Congress had passed the Economic Stimulus Act of 2008 (“the Act”) in order to stimulate the economy by spurring capital investment by corporations. The Act allows federal taxpayers to claim an extra 50 percent “bonus depreciation” on assets placed in service during 2008 and provides for increased expensing allowances under section 179 of the Internal Revenue Code.

The stimulus package created a dilemma for the Florida Legislature. Allowing businesses to apply the two increased federal deductions to their state taxes would have saved them, but reduced state revenues, a total of \$146.8 million in FY 2008-09. These losses would have been recouped in later years, as taxpayers’ depreciation deductions would be reduced; however, due to the very tight budget year, lawmakers decided to not pass these savings on to state corporate income taxpayers.

HB 5065 conforms the tax codes, but with two new adjustments. Taxpayers must add back the federal bonus depreciation and the section 179 deductions in excess of \$25,000 to their state taxable income. This allows businesses to keep one set of books and to use federal taxable income as the base for Florida’s tax. But the Legislature must quickly enact a subtraction adjustment so that these two federal provisions do not become a permanent state tax increase.

Problem Was Not Foreseen or Intended by the Legislature

The bonus depreciation and expense provisions of the bill were given a revenue neutral fiscal impact by the state estimators. Not allowing Florida taxpayers to take the federal tax breaks on their state returns avoids state revenue loss but the intention was to allow state taxpayers to continue taking their normal depreciation and expenses deductions. However, it is now apparent that HB 5065 was not correctly drafted resulting in some severe and unintended consequences.

On August 29, 2008, the Florida Department of Revenue (DOR) issued a Taxpayer Information Publication (TIP) indicating that there was “no corresponding subtraction or basis adjustment allowed for the amounts of bonus depreciation and section 179 expense required to be added back”. This interpretation means that if a taxpayer elects to take the federal bonus depreciation, they will also permanently lose 50 percent of that asset’s depreciation for state tax purposes.

Example of How the Federal Bonus Depreciation Creates a State Tax Increase

An example for a \$1 million asset with a 5-year life (straight line depreciation)

Normally, the taxpayer would deduct depreciation of \$200,000 a year (\$1 million / 5 years) on both their federal and state income tax returns.

Under the federal 50 percent bonus depreciation, the taxpayer can deduct \$600,000 on their federal tax return in the first year (\$500,000 + \$100,000) and \$100,000 for the next four years.

On the state return, the taxpayer must add back the 50 percent deduction to state taxable income for this year. Because Florida piggybacks, and because there is no provision for state taxpayers to recapture that 50 percent in subsequent years, the taxpayer would only be able to deduct \$100,000 a year for five years on the Florida return and the 50 percent (\$500,000) deduction would be lost forever. At the state's 5.5 percent corporate income tax rate, claiming the federal bonus would cost the taxpayer an additional \$27,500 in state taxes over the life of the asset.

The result is that many taxpayers will not take the federal bonus depreciation and will miss out on the intended economic stimulus effect. The federal bonus depreciation is a *speedup*, meaning a larger deduction in the first year and smaller deductions in the following years. However, the effect on Florida taxpayers is a permanent loss of depreciation and therefore a tax increase, making the federal bonus a losing proposition for many taxpayers and negating the stimulus.

Time is of the Essence: Fix Needed Now to Avoid Unintended Problems

This situation needs to be rectified quickly. On December 15, 2008, many taxpayers will make estimated federal tax payments. If the law is not clarified by this date, taxpayers will face a no-win situation where they will be forced to either forgo the federal bonus or face a state tax increase.

This problem cannot wait until the next General Session in March 2009. Even if taxpayers elect to take the federal bonus with the expectation that the problem will be corrected soon, they will still have to increase their estimated state tax payments (due January 1, 2009), which could create a real burden on cash-strapped businesses. Furthermore, many taxpayers will have to increase their state tax expense on their audited financial statements, which will reduce reported net income and could adversely affect shareholders.

Tax experts from the business community are working with legislative staff and the Department of Revenue to craft a solution that accomplishes the intent of the Legislature in a fashion that is revenue neutral and not unnecessarily burdensome administratively to either taxpayers or the state. **Florida TaxWatch recommends that the Governor and/or the Speaker and President call a special session so the Legislature can pass a technical correction to HB 5065, making it clear that, while Florida disallows a deduction for the federal stimulus depreciation and the additional expenses deductions allowed under federal law, such deductions are not lost for Florida tax purposes through normal amortization. The session call should be limited to this issue and should be held in conjunction with the Legislature's Organization Session, which will convene November 18, 2008.**

About Florida TaxWatch

Florida TaxWatch is a nonpartisan, nonprofit research institute that over its 29-year history has become widely recognized as the watchdog of citizens' hard-earned tax dollars. Its purpose is to provide the citizens of Florida and public officials with high quality, independent research and education on government revenues, expenditures, taxation, public policies and programs. The three-pronged mission of Florida TaxWatch is to improve taxpayer value, government accountability, and citizen understanding and constructive participation in their government.

This *Briefings* was written by Kurt Wenner, Director of Tax Research.

**David A. Smith, Chairman; Dominic M. Calabro, President, Publisher, and Editor;
Steve Evans, Chief Operating Officer; Robert Weissert, Director of Communications &
External Relations and Special Counsel to the President and CEO.**

Florida TaxWatch Research Institute, Inc.

www.FloridaTaxWatch.org

© Copyright Florida TaxWatch, November 2008



www.floridatxwatch.org

106 N. Bronough Street
P.O. Box 10209
Tallahassee, FL 32302

NON-PROFIT ORG.

U.S. POSTAGE
PAID

TALLAHASSEE, FL
Permit No. 409