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Keeping and Modernizing Florida's Corporate Income Tax Will Best Serve the State

Governor Rick Scott and legislative leaders are moving forward with a plan to cut corporate income tax revenues again after previous cuts in his first term.[1] Senate Bill 138, which would reduce corporate income tax collections by $19 million annually,[2] has been approved in two committees. Its companion bill, House Bill 49,[3] awaits action in the House of Representatives. Action on these bills comes amid a renewed pledge by Scott to end the tax entirely, as he first proposed when inaugurated in 2011.[4] SB 138 and HB 49 are another step toward eliminating the tax, legislators have said.[5]

> ***Weakening the state corporate income tax would reduce income available to meet state needs and further skew Florida's unfair tax system.***

Both reducing collections from the tax and eliminating it would have undesirable effects. Both would reduce income available to meet Florida's needs. Secondly, any reduction would further skew Florida's tax system, leaving others to assume a greater share of the responsibility for funding vital state services, making Florida's unfair tax system even more unfair.

Eliminating the tax would allow profitable corporations, many of them multistate and multinational, to escape paying for the benefits they receive from state-funded services such as education, infrastructure, public safety and the judicial system.

Proponents of doing away with the tax argue that it will make Florida more business-friendly and stimulate additional economic activity and jobs, although with little or no evidence to bear out those claims. Cutting the tax would do little if anything to improve an already business-friendly tax structure. But it would reduce revenues to fund the level of services necessary to support a good quality of life, which is the foundation of economic development.

A better alternative would be to modernize and strengthen the corporate income tax to make sure that profitable corporations pay their fair share and that other taxpayers don't bear a disproportionate share of the cost of state services.

Five key points argue for preserving and strengthening the tax.

(1) The state income tax is not an onerous levy on businesses in Florida. In fact, few pay anything, and those with annual profits of $1 million or more pay 94 percent of the total.

The state corporate income tax is paid by a small percentage of total businesses. It is not "the business tax" as Governor Scott repeatedly calls it.[6] It is specifically referred to in Florida statutes as the "corporate income tax."[7] Few businesses pay it and the great majority of those that do owe too little to hire even one Florida worker if allowed to forgo paying the tax.

Eliminating the corporate income tax would constitute a multi-billion-dollar annual gift to a few thousand highly profitable corporations.

Florida's corporate income tax – 5.5 percent of net profits, among the lowest in the nation[8] – is levied on only certain kinds of entities doing business in Florida. Generally, only businesses organized as a C corporation under Internal Revenue Service rules are subject to the tax. A tax is owed only if the corporation earned a net profit greater than the $50,000 exempted.[9] Most small businesses – because they are sole proprietorships or organized as S corporations, partnerships or limited liability companies (LLCs) – are exempt.

The income from these exempt businesses is passed through the business entity directly to the owner or stockholders, but it is not taxed by the state.

Such "pass-through" income is taxed in most other states through the state's personal income tax. But because Florida is one of only seven states without a broad-based personal income tax,[10] these businesses and owners pay no state income tax, either personal or corporate, on their profits.

Only three percent of Florida businesses paid any corporate income tax in the last year for which records are available. Of those that did, more than three out of four paid very little, an average of $147 each. Corporations with taxable profits above $1 million paid 94 percent of the total collected from the corporate income tax. The most profitable 452 corporations – with earnings more than $10 million – paid $1.4 billion of the total $1.8 billion collected.[11]

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Unfortunately, it is not known which corporations they are. Florida law specifies that corporate income tax returns are confidential.[12]

Who Pays?

State records show that more than 1.8 million active business entities exist in Florida – 749,000 domestic profit corporations, 155,000 domestic nonprofits, 57,000 foreign profit and nonprofit corporations, 848,000 limited liability companies and 39,000 partnerships.

Only about 11 percent (197,000) of that total filed a state corporate income tax return for 2012, the last year for which data is available. But about 145,000 of the corporations that filed a return paid no corporate income tax because they either lost money or had profits lower than the $50,000 of profit exempted. Only the remaining 52,600 corporations actually paid any Florida corporate income tax. **That number constitutes about three percent of active businesses registered in the state.**

Furthermore, the amount of tax paid by the vast majority of corporations is low. In 2012, more than 40 percent of the corporations that paid any tax recorded taxable profits (after the $50,000 exemption) of $5,000 or less. Another 37 percent of taxed corporations paid on taxable profits of $5,000-$50,000. Because of their low taxable income, therefore, almost 80 percent of corporations that paid anything – or 41,373 – owed small amounts to the state. All their tax payments combined totaled only $6 million, an average of $147 each.

Another 9,000 corporations paid tax on taxable profits of $50,000 to $1 million. They paid a total of $102 million, or an average of $11,200 each.

The remaining 2,162 corporations recorded net profits of $1 million or more. Combined, they paid $1.7 billion of the $1.8 billion the corporate income tax brought in from all corporations – or 94 percent of total tax payments. The top 452 corporations – those with taxable earnings of $10 million or more – combined to pay $1.4 billion.

(Source: Florida Department of Revenue)

(2) Little Evidence Exists That Corporate Income Tax Cuts Produce Jobs

Reducing or eliminating the state corporate income tax is unlikely to lead to creation of a significant number of jobs. State and local taxes on business, of which the state corporate income tax is a small part when sales taxes and property taxes are considered, represent only about two percent of total business costs.[13]

A state's corporate income tax rate was ranked seventh among site selection factors in Area Development magazine's corporate survey – behind availability of skilled labor, highway accessibility, labor costs, occupancy or construction costs, availability of advanced information and communications technology and available buildings.[14]

The nonpartisan National Conference of State Legislatures, in its tax handbook for legislators, advises that "…[A]s long as overall state tax burdens (income, sales, property and other taxes combined) are not excessive compared to other states, taxes are rarely as important as labor, energy and transportation costs" in business location decisions.[15]

State corporate income tax cuts do not pay for themselves, critics of cuts say. "The small economic impacts of state corporate tax cuts and the large loss of revenue mean that such cuts do not stimulate enough new taxable economic activity — and thus enough new revenues — to fully offset the revenues lost" from the tax cut. "…[M]ost objective research on the issue concludes that state corporate tax cuts are unlikely to have a significant positive impact on state economies."[16]

The corporate income tax, even with exemptions and tax credits siphoning hundreds of millions annually from collections, is a major source of revenue used to fund basic state services.

(3) Florida is Already Known as One of the Most "Business-Friendly" States

Proponents of eliminating the state corporate income tax for some or all corporations maintain that it will improve Florida's business climate and lead to more economic activity and jobs. No evidence has been presented by Florida proponents of cuts that the corporate income tax is an obstacle to job creation. And Florida already rates among the top states in the nation in many assessments of business climate.

For example: the Tax Foundation ranks Florida's business tax climate as the fifth-best among the 50 states and the District of Columbia, just as it has every year since 2006.[17] Area Development magazine also ranks Florida with the fifth-best business climate.[18] Chief Executive magazine called Florida the second-best place for businesses in 2014.[19] Site Selection magazine's 2014 executive survey ranked Florida's business climate eighth in the nation.[20]

Enterprise Florida, the state's economic development arm, touts Florida's "highly favorable business climate"[21] and "pro-business tax structure"[22] even with the corporate income tax as it exists today.

(4) The Corporate Income Tax is a Significant Revenue Source for the State

The corporate income tax, even with exemptions and tax credits siphoning hundreds of millions annually from collections, is a major source of revenue used to fund basic state services. It is expected to produce more than $2.2 billion in revenue in the 2014-15 fiscal year, about eight percent of general revenue collections and the second-largest source of general revenue behind the state sales tax.[23] Reducing or eliminating that revenue would mean less would be available for services such as education, health care, child welfare and the court system.

Squeezing funds available for public services could adversely affect long-term growth. "Businesses need and demand high-quality education systems to educate and train their workers and well-functioning infrastructure to get their employees and supplies to their plants and their products to customers. They need good police and fire protection for their facilities, which need to be located in areas that offer good schools and public recreation facilities in order to attract senior managers, engineers, and other highly paid personnel." Paying for corporate income tax cuts by squeezing state services and lowering their quality makes the state less attractive to both its residents and to businesses deciding where to locate or expand.[24]

(5) Corporate Tax Cuts Would Force Others to Pay Disproportionately More

Without the corporate income tax as it now exists, the state would be even more reliant on the regressive sales tax to fund state services. The sales tax already requires low- and moderate-income Floridians to pay a much larger share of their income in taxes than more affluent residents, and the differences are large enough to make Florida's tax system the second most regressive (that is, unfair) in the nation.[25]

Without the corporate income tax, Florida would be even more reliant on the regressive sales tax to fund services. The state's tax system already is the second-most unfair in the nation.

Proponents of cuts in the corporate income tax maintain that consumers, not corporations, ultimately pay business taxes through higher prices. Yet that may not be the case, as the architect of Florida's state corporate income tax showed 45 years ago.

The tax came into being after a state senator, Reubin Askew, won his campaign for governor in 1970 on a "Fair Share Tax Program" that included a tax on corporations that he said didn't pay enough for state services that benefited them. A newspaper story at the time captured his belief: "Askew charged that Florida's taxes, which are primarily consumer based, seem 'almost purposely designed to place the cost of government squarely on the shoulders of middle-and low-income citizens while allowing many privileged interests to escape virtually tax-free.'"[26]

During his campaign, he compared the prices of items sold in Florida to the same items sold in Georgia, which already imposed a corporate income tax. Because the prices were the same, he concluded that multistate corporations were making a greater profit from Florida consumers than from Georgians. When elected, he won voter approval of an amendment to the state constitution establishing the corporate income tax.

Multistate and multinational corporations that pay the tax in Florida would not necessarily spend any tax savings in Florida. Most stock in such corporations is owned by individuals or institutions outside the state, and "a substantial portion of whatever corporate spending is stimulated by receiving an income tax cut is likely to occur out of state, where the employees, suppliers, or stockholders are located. Only a small amount of the tax cut is likely to trickle back into the state in the form of increased spending." Shareholders, "the majority of whom reside out of state, should not get a free ride."[27]

Corporate Income Tax Should Be Strengthened, Not Eroded or Ended

Florida's corporate income tax structure is flawed, but not because it taxes too many businesses too much. Rather, it contains so many loopholes that one tax expert has called it "a voluntary tax" paid only by those too honest or unfortunate to escape it.[28]

Closing loopholes so that the tax is paid by a greater number of profitable corporations would not only yield more revenue for state services but also increase fairness, making sure that corporations pay their fair share for the state services from which they benefit.

Corporations can limit their corporate income tax liabilities under current state law in several ways.

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- **Tax avoidance behavior.** "Many features of state corporate income tax laws make it possible for multi-state businesses to legally avoid these taxes," a Florida Senate report has said. "State and local tax planning has become more important, and corporations have become more adept at exploiting features of state tax structures that allow them to avoid these taxes."[29] Tax avoidance strategies include artificially shifting profits to out-of-state subsidiaries, incorporating offshore and creating so-called "nowhere income" not taxable in any state.[30] One remedy for some tax avoidance efforts, called "combined reporting," treats a business composed of a parent corporation and subsidiaries as a single corporation for tax purposes. It has been proposed repeatedly in the legislature without success.

  Adopting combined reporting in Florida would yield about $491 million annually. Adopting a "throwback rule" to ensure that Florida receives its fair share of taxes on revenue earned in the state would yield about $50 million annually.[31]

- **Corporations can avoid paying corporate income taxes by the way the business is organized.** By far the costliest exemption is for S corporations (named after a section of the Internal Revenue Code). Ending the state corporate income tax exemption for S corporations would yield about $716 million a year.[32] Since changes in federal law made more businesses eligible for S status, their number has ballooned in Florida. In 2013, Florida was home to 595,000 S corporations, considerably more than in any other state.[33]

Similarly, after an exemption for limited liability companies was created in Florida in 1998,[34] the number of LLCs registered in the state mushroomed from 5,392 to 38,639 by 2002[35] and to 848,000 today.[36] In 2012 alone, about 170,000 new LLCs were registered in Florida.[37] The exemption from the state corporate income tax for LLCs is estimated to cost the state $179 million annually.[38]

- In addition to those tax avoidance strategies, **corporations may lower their tax payments by using one of at least 18 other corporate tax breaks provided in state law.[39]** These are called "tax preferences" or "tax expenditures," because they cost the state money just as appropriations do: "Preferential tax treatments reduce government revenue and compete with programs funded by appropriations for state and local resources....Once adopted, tax preferences often receive less scrutiny than appropriations, which must be enacted every year. Tax preferences remain effective until a positive action is taken to change them. Unlike appropriations, which are for fixed amounts, tax preferences are often open-ended."[40]

Tax credits for private school vouchers siphon hundreds of millions of corporate tax dollars from the state treasury.

Many of those breaks are designed to create jobs. But the conservative Tax Foundations says "Economic development and job creation tax credits complicate the tax system, narrow the tax base, drive up tax rates for companies that do not qualify, distort the free market, and often fail to achieve economic growth."[41]

- Because corporate tax returns are confidential under state law, it is not possible to know which corporations pay the income tax and how much they pay. But an estimate can be made using corporate profit information required by the Securities and Exchange Commission. An examination of that information found that 13 Florida-based Fortune 500 corporations paid total state corporate income taxes of 2.7 percent of profits, half of Florida's 5.5 percent tax rate.[42] This data provides confirmation of corporations' successful use of tax avoidance strategies.

Tax Credit Private-School Voucher Program a Big Drain on Corporate Tax Collections

The Florida Tax Credit Scholarship Program, which provides vouchers to about 67,000 students to attend private schools, is a huge drain on receipts of the corporate income tax. Under the program, corporations are allowed to pay for vouchers and receive a dollar-for-dollar reduction in their state taxes, primarily the corporate income tax.[43]

In the 2014-15 fiscal year, corporations can divert up to $358 million from the state treasury to private school tuition.[44] The amount can increase each year, depending on the number of students attending private schools in the program, to $448 million in 2015-16, $559 million in 2016-17 and by ever-larger amounts thereafter.

Conclusion

Cutting Florida's corporate income tax would further unbalance the state's tax structure, require other taxpayers to pay proportionately more for services and reduce revenue available to fund services. The rationale for reducing and eventually eliminating the tax completely – that it will produce job growth – Is unsubstantiated. Florida is already recognized as one of the most business-friendly states, and executives rank corporate income taxes behind many other factors when choosing sites for business location.

A better course of action would be to modernize the corporate income tax to ensure that all corporations pay their fair share of the costs of services to help make state revenue adequate to meet Florida's needs.

This report was researched and written by Alan Stonecipher. Karen Woodall is executive director of the Florida Center for Fiscal and Economic Policy. This work was supported by Florida New Majority.
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Endnotes

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