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DATE: January 3, 2002

**HOUSE OF REPRESENTATIVES
AS REVISED BY THE COMMITTEE ON
JUDICIAL OVERSIGHT
ANALYSIS**

BILL #: HB 169

RELATING TO: Taxation

SPONSOR(S): Representative Weissman

TIED BILL(S): None

ORIGINATING COMMITTEE(S)/COUNCIL(S)/COMMITTEE(S) OF REFERENCE:

- (1) FISCAL POLICY AND RESOURCES YEAS 11 NAYS 1
 - (2) JUDICIAL OVERSIGHT
 - (3) FISCAL RESPONSIBILITY COUNCIL
 - (4)
 - (5)
-

I. SUMMARY:

This bill makes several changes to Florida's tax collection procedures, primarily affecting business entities. It allows a taxpayer to establish overpayment of sales and use tax through sampling when applying for a refund, not in connection with an audit. It provides for a *de novo* review by a court of whether a taxpayer's non-compliance with Florida's tax laws was due to reasonable cause. Under present law, if non-compliance is due to reasonable cause, the Department of Revenue may settle or compromise penalties of less than 25%, and it must settle or compromise penalties of more than 25%. The proposed change will allow a court to review the Department's determination. The bill requires that the tax classification of a single-member entity under sections 7701 and 7704 of the Internal Revenue Code is determinative as to Florida so the entity will not be treated differently for purposes of Florida and federal income tax. This bill also provides that certain single-member limited liability companies that are disregarded for federal income tax purposes must be treated as separate legal entities for non-income tax purposes.

The Revenue Estimating Conference has not yet adopted an official estimate on the corporate income tax portion of this bill. However, the sales and use tax impact of the change to refund applications is estimate to have a negative \$4.4 million impact to General Revenue, and a negative \$0.9 million impact to local revenues for a total negative impact of \$5.3 million.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

- | | | | |
|-----------------------------------|---|-----------------------------|---|
| 1. <u>Less Government</u> | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/> |
| 2. <u>Lower Taxes</u> | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/> |
| 3. <u>Individual Freedom</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 4. <u>Personal Responsibility</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 5. <u>Family Empowerment</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |

For any principle that received a "no" above, please explain:

B. PRESENT SITUATION:

When contesting the legality of any assessment or denial of refund of any tax, fee, surcharge, permit, interest, or penalty, a taxpayer has two choices of venue¹ under as provided under s. 72.011, F.S.: the Second Judicial Circuit Court in and for Leon County, or in the county where the taxpayer resides or maintains its principal commercial domicile in this state. For corporate and other entity taxpayers, particularly multistate taxpayers, it is unclear where the taxpayer may "reside" or have its "principal commercial domicile." Proper venue is jurisdictional²; therefore, if a taxpayer selects the wrong venue the case is dismissed, not transferred. If the case is dismissed, the statute of limitations may run out on the claim before the taxpayer can file the case in the correct court.

Section 215.26(2), F.S., requires a taxpayer to submit an application for any refund of all funds paid into the State Treasury on a form approved by the Comptroller, and to provide additional proof as deemed necessary to establish the refund requested. Section 212.12(6)(c), F.S., provides that a sales and use tax refund or overpayment may be verified by the Department of Revenue through a sample when records are adequate but voluminous during the period being audited, but such verification is not required. Sampling of records regarding fixed assets is not allowed. This section applies to overpayments found during compliance audits and to verification of amounts requested on a refund application. When records are not adequate during the refund period, the sales and use tax refund request will be verified by the Department of Revenue through a detailed examination of the available records. A taxpayer is not permitted to establish an overpayment of sales and use tax through sampling except in the context of an audit.

Current law provides for penalties to be assessed for tax delinquencies. Section 213.21, F.S., authorizes DOR to settle or compromise a taxpayer's liability for penalties if it determines that the taxpayer's noncompliance was "due to reasonable cause and not to willful negligence, willful

¹ Venue is the location in which the case is properly filed. For example, while all small claims courts in the state of Florida might jurisdiction over a landlord-tenant dispute, the proper venue would be exclusively in the small claims court in the county where the leased property was located.

² A jurisdictional factor is one that must be met in order for the court to have jurisdiction over the matter. If the case is not within a court's jurisdiction the court may not take any action regarding the case

neglect, or fraud.” A taxpayer’s liability for penalties in excess of 25 percent³ of the tax must be settled or compromised if DOR determines that the noncompliance was due to reasonable cause.

The Florida Income Tax Code specifies those entities that are subject to tax and required to file returns. Internal Revenue Code ss. 7701 and 7704, and regulations issued thereunder, permit a business entity to elect whether to be treated as a corporation, partnership, or disregarded entity for federal income tax purposes. The differences in Federal and Florida law on how entities are classified can result in an entity being subject to tax by one level of government but not by the other. For example, an entity could be treated as a disregarded entity and not subject to tax under federal law, but taxed as a corporation under Florida law.

Section 608.471, F.S., provides, in part, that a limited liability company classified as a partnership or single member limited liability company that is disregarded as an entity separate from its owner for federal income tax purposes is not required to file a separate return under the Florida Income Tax Code. The statutes do not address how single-member limited liability companies or other entities disregarded for federal income tax purposes are treated for non-income tax purposes, and the Department of Revenue has no rulemaking authority in this area. This creates problems for single-member limited liability companies that are treated as pass-through entities for federal income tax purposes but require separate treatment for sales and employment tax purposes.

C. EFFECT OF PROPOSED CHANGES:

See “Section-by-Section Analysis”.

D. SECTION-BY-SECTION ANALYSIS:

Section 1 amends ss. 72.011(4) and (5), F.S., to provide that an action for a refund can be filed where a taxpayer regularly maintains its books and records in this state, and to provide that the venue of actions filed under s. 72.011, F.S., is not jurisdictional. Therefore, if the taxpayer files a case in the wrong court, the case can be transferred instead of dismissed.

Section 2 amends s. 212.12, F.S., to provide that a taxpayer is entitled to establish an overpayment through a statistical sample, in connection with a compliance audit or an application for refund when its records are adequate, but voluminous. Any other sampling method can be used if agreed upon by the taxpayer and the Department of Revenue.

Section 3 amends s. 213.21, F.S., to provide that the Department of Revenue’s determination of whether a penalty should be settled or compromised due to reasonable cause is subject to *de novo*⁴ review in any administrative proceeding or judicial action challenging a penalty assessment. Therefore, a taxpayer will have an opportunity to convince a trial court that there was reasonable cause for the noncompliance with the tax laws, and the trial court will have the authority to waive the penalty if convinced.

Section 4 amends s. 220.03(2), F.S., to provide that the tax classification of a business entity, as determined under sections 7701 and 7704 of the Internal Revenue Code, is determinative of the entity’s classification under the Florida Income Tax Code, even though other provisions of the Florida income tax code call for a different classification. Therefore, the entity will be treated the same for purposes of Florida and federal income tax.

³ As an example, a sales tax dealer who fails to remit sales tax due to the state in a timely manner will incur a penalty of 10% for each 30 days or fraction thereof the payment is late by, up to a maximum of 50%. If this failure was due to reasonable cause the Department of Revenue is obligated to reduce this penalty to 25%.

⁴ A *de novo* review is a complete retrial of the issue in which new evidence is presented. Under a *de novo* review no weight is given to the previous judgment.

Section 5 amends s. 608.471, F.S., to provide that single-member limited liability companies and other entities that are disregarded for federal income tax purposes must be treated as separate legal entities for all non-income tax purposes, and directs the Department of Revenue to adopt rules to take into account that single-member disregarded entities may report and account for income, employment, and other taxes under the taxpayer identification number of the owner of the single-member entity.

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

This bill may have an impact on corporate income tax collections, by changing how entities are treated under the Florida income tax code. The magnitude of this effect on tax revenue, if any, has not been determined by the Revenue Estimating Conference.

The Revenue Estimating Conference has adopted an official estimate of negative \$4.4 million to General Revenue for that portion of the bill which changes the processing of refund requests.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

This bill will reduce local revenues by \$0.9 million.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None other than reduced tax liabilities described herein.

D. FISCAL COMMENTS:

The tax law changes provided by this bill have been proposed by the Tax Section of the Florida Bar and according to that organization these changes will enhance the fairness of Florida's tax system, promote equal treatment for all taxpayers, and provide sound tax policy for the state.

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

This bill does not require counties or municipalities to spend funds or to take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This bill does not reduce the authority that municipalities or counties have to raise revenues in the aggregate.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

This bill does not reduce the percentage of a state tax shared with counties or municipalities.

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

None.

B. RULE-MAKING AUTHORITY:

This bill will expand the rulemaking authority of the Department of Revenue.

C. OTHER COMMENTS:

The Department of Revenue has indicated that they expect a significant operational impact from this bill as they anticipate an increase in the number of refund requests received and a commensurate increase in the number of staff hours required to process these refund requests. Currently, the Department of Revenue and representatives of The Florida Bar are working with the sponsor to craft an amendment to this bill to reduce this operational impact.

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

None.

VII. SIGNATURES:

COMMITTEE ON FISCAL POLICY AND RESOURCES:

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