

Florida Corporation Income Tax

Multi-State Planning Opportunities

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Corporations that do business in more than one state usually have the honor of filing corporate income tax returns for each state in which they have nexus.

Tax practitioners who have the responsibility of preparing federal income tax returns usually are also delegated the honor of preparing the various state income tax returns.

This gives tax practitioners the unique opportunity to expand their knowledge of various state laws, rules and forms that can drastically differ from jurisdiction to jurisdiction.

In the past, tax practitioners' major emphasis regarding state taxes has usually been limited to the preparation of state income tax returns. Since most state laws are different and income tax forms vary greatly, tax practitioners have always spent a tremendous amount of time completing out-of-state income tax returns.

Most tax planning that occurred was to help reduce federal tax liabilities with the consequential result a reduction in state income tax liabilities. State taxes were often an after thought and planning would only occur after the fact when unexpected tax liabilities arose.

Today, tax practitioners need to look beyond the complex filing requirements of various states and be proactive instead of reactive when dealing with state taxes.

State taxes can and should be effectively planned and controlled. With effective planning, multi-state corporations can reduce their overall state income tax liability to substan-

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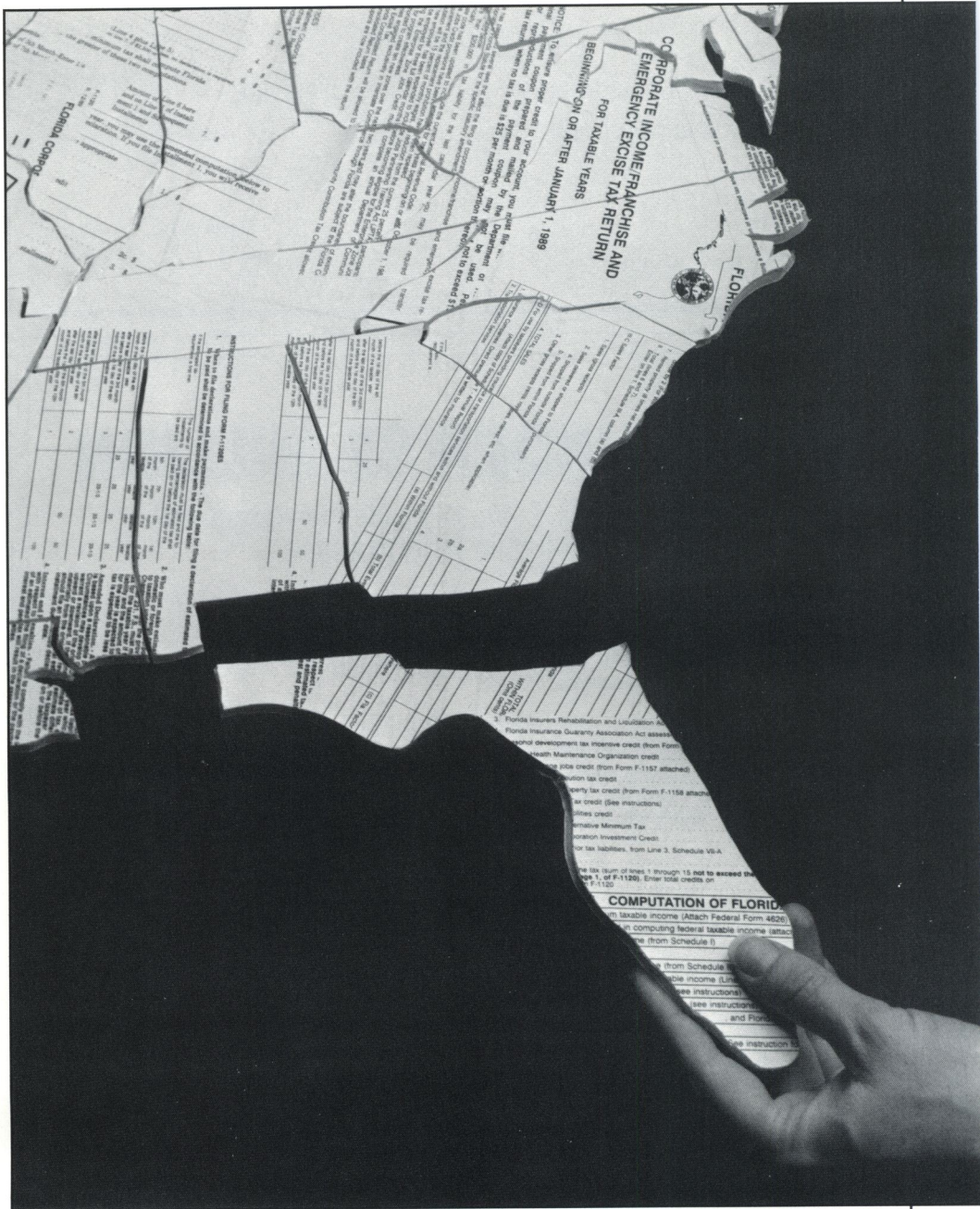


Exhibit I
ABC Company

	Division 1 (Florida)	Division 2 (State A)
Sales	10,000,000	10,000,000
Payroll	4,000,000	4,000,000
Fixed assets	25,000,000	25,000,000
Profit before taxes	2,000,000	0

Assume, for purposes of this example, that State A and Florida are calculated the same.

Exhibit II
Tax Calculation

State income before taxes	2,000,000
Apportionment factor	x 50 percent
	1,000,000
Rate	5.5 percent
Tax to each state	55,000

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State Tax Notes

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tially less than the average tax rate of the states in which they file.

State Tax Similarities

Although the state income tax laws vary greatly throughout the country, there are some generalities that can be made:

1. Most states calculate state taxable income based on federal taxable income plus or minus certain adjustments.

2. Groups of corporations that file consolidated income tax returns for federal income tax purposes often can file consolidated, combined or separate returns for state tax purposes.

3. For multi-state corporations, states require an allocation of state taxable income between the various states in which a company does business. The most common method used by the states is a three factor apportionment formula that calculates a percentage of income earned in each state based on the total sales, assets and payroll from each state.

In addition, many states require multi-state corporations to specifically allocate non-business income (i.e., interest, dividends and rents) to the state in which the income was earned.

Theory of the Apportionment Formula

The theory of the three factor apportionment formula is that there is a direct correlation between the percentage of income earned by a corporation in each state and the average percentage of the three factors located in each state.

The apportionment percentage, however, is not a true allocation for many corporations. In many cases where multi-state corporations have separate profit and loss statements by state, true corporate earnings by state vary significantly from the amount calculated in the apportionment formula. Where this is the case, significant planning opportunities exist to reduce overall state tax liabilities.

Steps for Effective Planning

To properly plan for state taxes in multi-state corporations, the tax practitioner must first look at the organization from a state tax standpoint. The starting point is to review the most recent state tax returns that were filed. In particular, an analysis of state tax liabilities, allocable and apportionable income and the elements of the apportionment factors should be made.

The second item needed is an estimate of actual profit or loss for each location in which the company does business. Many multi-state corporations have separate divisions for different locations, with each division being a different profit center.

Next, the tax practitioner must have a working knowledge of the state tax laws for each state in which the company does business. This step includes an understanding of business vs. non-business income, differences in additions and subtractions from federal taxable income and the availability of

Exhibit III	
Florida Apportionment Calculation	
Sales	$10,000,000 / 20,000,000 = 50 \text{ percent} \times .5 = .25$
Payroll	$4,000,000 / 8,000,000 = 50 \text{ percent} \times .25 = 12.5$
Fixed assets	$25,000,000 / 50,000,000 = 50 \text{ percent} \times .25 = 12.5$
Florida apportionment factor	50 percent

consolidated vs. separate returns.

After attaining a good knowledge of state tax laws, the tax practitioner should then build a model that would minimize state tax liabilities based on the information gathered in the previous steps. This model could in-

clude setting up new subsidiaries, merging existing subsidiaries or liquidating subsidiaries.

Finally, after the model is complete, the tax practitioner should first analyze the proposed restructuring to

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Exhibit IV

**Restructure to a Florida Holding Company
with a Subsidiary in State A**

Florida tax would be the same:
\$55,000

State A tax would be zero

50 percent savings to the company

**State
Tax Notes**

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ensure that no federal income tax issues are created by the restructuring. Once this is complete, the tax practitioner should then discuss the ultimate state tax structure with management and legal counsel to ensure that the proposed structure would

work within the organization. If it does not work, as is often the case, a second, third or even fourth alternative needs to be analyzed.

Example

ABC Company has two operating divisions: Division 1 located in Florida and Division 2 in State A. For the year just ended, the company has been very profitable with earnings before taxes totaling \$2 million. Each division is of equal size in terms of

sales, payroll and fixed assets (see Exhibit I).

Division 2 was a recent acquisition in which the company assumed a significant amount of debt. Due to this fact, the division is at a break-even point after payment of the interest on the debt.

Assuming that the state tax laws in Florida and State A are identical, ABC Company is presently paying approximately \$110,000 in State income taxes (see Exhibit II).

Based on the facts, ABC Company should restructure by placing Division 2 into a separate subsidiary. The new subsidiary would file a separate income tax return in State A that would show no profit, and correspondingly there would be no income tax liability in State A.

In Florida, the new group should elect to file a consolidated return. The tax in Florida would remain at \$55,000 since the consolidated group would have an apportionment factor of 50 percent as prior to the restructuring (see Exhibit III). This totals a 50 percent tax savings to ABC Company (see Exhibit IV).

Conclusion

Multi-state corporations have unique planning opportunities available to them. The interplay of different state laws can lower the overall effective state tax rate to less than the average state tax rate for the states in which they do business.

Tax practitioners should actively analyze multi-state companies to ensure that state tax liabilities are minimized. ■



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