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Florida corporate  
income tax

Reporting of federal  
audit adjustments

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## Florida Corporate Income Tax: Reporting of Federal Audit Adjustments

**T**he Florida Corporate Income Tax (FCIT) adopts the Internal Revenue Code<sup>1</sup> as the starting point to compute Florida taxable income.<sup>2</sup> If an Internal Revenue Service (IRS) audit results in adjustments to items that would change the computation of a taxpayer's Florida taxable income, following the conclusion of the federal audit,<sup>3</sup> the Florida taxpayer is generally required to file an amended FCIT return to report the IRS redetermination of its federal income pursuant to F.S. §220.23(2). This article discusses the recommended procedures that a Florida taxpayer should follow to meet the filing requirements provided in F.S. §220.23(2) following an IRS audit.

The general statute of limitation for the assessment of tax applicable to the FCIT is provided in F.S. §95.091(3). The statute provides that the Florida Department of Revenue (FDOR) may assess any additional FCIT due within three years "after the date the tax is due, or such return is filed, whichever occurs later."<sup>4</sup> Generally, a Florida taxpayer is required to file a refund claim for FCIT within three years after the right to the refund has accrued under F.S. §215.26(2).<sup>5</sup> A Florida taxpayer would be required to file a refund claim within three years of the due date for the FCIT return, including valid extensions.<sup>6</sup> These two limitation periods are modified for amended FCIT returns required as a result of federal audit changes pursuant to F.S. §220.23(2).

### Filing Requirements as the Result of Federal Audit Changes

F.S. §220.23(2) provides that under most circumstances a Florida taxpayer is required to file an amended FCIT return (FDOR Form F-1120X) with the FDOR within "60 days after such adjustment has been agreed to or finally determined for federal income tax purposes" to report any redeterminations of federal income. A Florida taxpayer is not required to file an amended return in cases when 1) the federal change is limited to a carryback of a net operating loss or a capital loss or 2) the only effect is to increase or decrease a net operating loss.<sup>7</sup> The amended FCIT return is limited to the federal items that were adjusted by the IRS.<sup>8</sup> If the federal redetermination results in an increase to federal taxable income, then the Florida taxpayer will generally be required to file an amended FCIT return reporting additional tax due, as well as interest computed from the original due date of the return until paid to the FDOR.<sup>9</sup> If the federal redetermination results in a decrease to federal taxable income, then the Florida taxpayer will generally be entitled to a refund of tax previously paid to the FDOR.<sup>10</sup>

For example, assume that the IRS determined that a taxpayer was required to increase its federal taxable income in the amount of \$1,000,000 due to a disallowance of meals and entertainment expenses and the Florida taxpayer's original return reported a 10 percent Florida apportionment factor. Assuming no other items are required to be considered in the recomputation of Florida tax, the taxpayer would be required to

file an amended FCIT return and pay an additional \$5,500<sup>11</sup> of FCIT, plus interest. In a second example, assume the same facts as above, except that instead of a \$1,000,000 increase to taxable income, the IRS determined that the taxpayer was entitled to increased meals and entertainment expenses of \$500,000. In this second example, the Florida taxpayer would be entitled to a refund of \$2,750.<sup>12</sup>

In the event that an amended FCIT return is required to be filed to report federal changes pursuant to F.S. §220.23(2), the amended return must be filed with the FDOR within "60 days after such adjustment has been agreed to or finally determined for federal income tax purposes, or after any federal income tax deficiency or refund, abatement, or credit resulting therefrom has been assessed, paid, or collected, whichever shall first occur."<sup>13</sup> However, a payment of disputed federal tax amounts when necessary to contest a federal assessment in court does not constitute tax "paid" for the purpose of the 60-day filing requirement under F.S. 220.23(2)(a)3.<sup>14</sup> There may be situations when the IRS and taxpayer agree to some items of redetermination and disagree with others. In this situation, the Florida taxpayer would be required to file an amended FCIT return within 60 days of the agreed changes.<sup>15</sup> As the remaining issues are agreed to or finally determined, additional amended FCIT returns are required to be filed within 60 days of the agreement or final determination.<sup>16</sup>

For example, assume that the IRS audited a Florida taxpayer for the tax year ending December 31, 2010,

and proposed to disallow the following items: (a) \$500,000 in interest expense deductions; (b) \$300,000 in depreciation deductions; and (c) \$15,000,000 in operating expense deductions. Further, assume that the Florida taxpayer agreed with items (a) and (b) and the IRS and taxpayer executed a written agreement for items (a) and (b) on January 30, 2014.<sup>17</sup> Finally, assume that the Florida taxpayer paid the tax relating to item (c) under protest and litigated item (c) in the U.S. district court, which entered a judgment on November 13, 2015, sustaining the disallowance of \$2,000,000 of the disputed operating expenses and permitting the deduction of \$13,000,000 of the disputed operating expenses. Neither the IRS nor the Florida taxpayer appealed the decision of the U.S. district court, which became final on January 15, 2016.<sup>18</sup> The Florida taxpayer in this example would be required to file an amended FCIT return by March 31, 2014, to report the agreed to changes for (a) and (b) and pay the additional FCIT plus interest to the FDOR. The Florida taxpayer would also be required to file an amended FCIT return by March 15, 2016, and pay additional FCIT and interest to the FDOR to report the final determination by the U.S. district court related to item (c) sustaining the disallowance of \$2,000,000 of the operating expenses.<sup>19</sup>

### **Assessment and Refunds — Limited to Scope of Federal Income Adjustments**

F.S. §220.23(2)(c) provides that the FDOR may assess additional tax due for adjustments within five years after the amended return is filed to report any redeterminations of federal income. The FDOR is authorized to assess additional tax at any time if the taxpayer does not file an amended return reporting the adjustments to federal income. In addition, the FDOR may assess a penalty for failure to timely file the amended return.<sup>20</sup> The assessment is limited to the federal items that are adjusted.<sup>21</sup>

For example, assume that the IRS audited a Florida taxpayer and determined that the Florida taxpayer

## **A Florida taxpayer that is audited by the IRS should be aware that it may have a requirement to file amended FCIT returns to report federal audit changes.**

incorrectly omitted interest income it received from a U.S. bank account from its federal income tax return for tax year ending December 31, 2009. The IRS and the Florida taxpayer executed a written agreement on November 13, 2015, agreeing to the addition of this interest income to taxpayer's taxable income. The Florida taxpayer timely filed an amended FCIT return with the FDOR on December 11, 2015, reporting the federal adjustment relating to the interest income and paid the additional FCIT and interest due in accordance with the requirements of F.S. §220.23. The FDOR did not audit the originally filed FCIT return for tax year ending December 31, 2009. However, the FDOR did audit the FCIT amended return for the tax year ending December 31, 2009, on March 14, 2016, and disagreed with a nonbusiness income subtraction taken by the Florida taxpayer relating to the sale of a subsidiary corporation. The FDOR agreed with the additional interest income reported on the amended FCIT return as a result of the federal audit.<sup>22</sup> However, in this situation, the FDOR's ability to sustain an assessment of additional tax related to the disputed nonbusiness income subtraction is unlikely.

The general Florida statute of limitations for assessments, F.S. §95.091(3), provides that the FDOR must assess additional FCIT within three years after "the date the tax is

due, any return with respect to the tax is due, or such return is filed, whichever occurs later."<sup>23</sup> The original FCIT return due date for tax year ending December 31, 2009, would be April 1, 2010.<sup>24</sup> If the Florida taxpayer obtained a valid six-month extension of time to file the 2009 return, the extended due date would be October 1, 2010.<sup>25</sup> In this example, the FDOR is authorized under F.S. §95.091(3) to assess additional FCIT for tax year ending December 31, 2009, by April 1, 2013, if no extension was filed or October 1, 2013, if an extension was filed.<sup>26</sup> Because the FDOR audited the Florida taxpayer's amended return for the tax year ending December 31, 2009, on March 14, 2016, the audit occurred after the expiration of the general Florida statute of limitations. In a situation in which an amended return is required to report federal audit adjustments, F.S. §220.23(2)(c) provides that the FDOR can assess additional FCIT within five years after the Florida taxpayer files the required amended FCIT return. However, F.S. §220.23(2)(c) specifically provides that regardless of whether a taxpayer files a required amended FCIT return, "the amount of any proposed assessment...shall be limited to the amount of any deficiency resulting under this code from recomputation of the taxpayer's income for the taxable year after giving effect only to the item or items reflected in the adjustment." In this example, the federal audit adjustment related to interest received from a U.S. bank account. If, however, the FDOR attempted to assess additional FCIT based on a disallowance of the nonbusiness income subtraction claimed by the Florida taxpayer on the original return, this portion of the assessment is unlikely to be sustained.

If the facts of the above example are the same except that the federal adjustment related to capital gains on the sale of the Florida taxpayer's subsidiary corporation instead of interest from a U.S. bank account, then the possibility exists that the FDOR may be able to sustain an assessment of additional tax relating to the disallowance of the nonbusiness income subtraction.<sup>27</sup> In such

a case, the Florida taxpayer would be entitled to challenge the department's assessment of additional FCIT through informal and/or formal appeals processes.<sup>28</sup>

F.S. §220.23(2)(d) provides that if an IRS audit results in adjustments to items that would change the computation of a taxpayer's Florida taxable income, and that change results in an overpayment of FCIT, a taxpayer is entitled to file an amended FCIT return claiming a refund of the overpayment. The refund claim must be made within two years of the date the amended return is due.<sup>29</sup> The refund is limited to the overpayment resulting from "recomputation of the taxpayer's income for the taxpayer year after giving effect only to the item or items reflected in the adjustment required to be reported."<sup>30</sup>

For example, assume the IRS audited a Florida taxpayer and determined that the Florida taxpayer was entitled to additional depreciation deductions for tax year ending December 31, 2009. The IRS and the Florida taxpayer executed a written agreement on November 13, 2015, agreeing to the changes. The Florida taxpayer would, therefore, be entitled to timely file an amended FCIT return with the FDOR reporting the federal adjustment relating to the increased depreciation deduction and requesting a refund of FCIT for that federal adjustment item. The Florida taxpayer reviewed its FCIT return, following the conclusion of the IRS audit, and determined that it incorrectly computed its 10 percent Florida apportionment factor by sourcing sales of petroleum to Florida because the taxpayer's petroleum sales office was located in Florida. A correction to the Florida apportionment factor to source sales of petroleum to Florida only if delivered to a Florida location under F.S. §220.15(5)(b)1 would result in a reduced Florida apportionment factor of five percent and a potential refund. However, in this situation, the taxpayer's likelihood of successfully claiming a tax refund related to the revised apportionment factor is low.

The general Florida statute of limitations for refund claims, F.S.

§215.26(2), provides that a Florida taxpayer must file a FCIT refund claim with the FDOR within three years of the time that the right to the refund accrued. The original FCIT return due date for tax year ending December 31, 2009, would be April 1, 2010.<sup>31</sup> If the Florida taxpayer obtained a valid six-month extension of time to file the 2009 return, the extended due date would be October 1, 2010.<sup>32</sup> Therefore, the general Florida statute of limitations would expire on April 1, 2013, or if the taxpayer obtained a valid extension, on October 1, 2013. Because the agreement between the taxpayer and the IRS occurred on November 13, 2015, the audit adjustment occurred after the standard Florida statute of limitations had expired.

When an amended return is required to report federal audit adjustments, F.S. §220.23(2)(d) provides that a Florida taxpayer can seek a refund of FCIT previously paid to the FDOR within two years after the amended return is due. However, as noted above, the refund claim is limited to FCIT relating to items that are adjusted by the IRS. In this case, the federal audit adjustment related to an increase in depreciation expenses. Therefore, it is unlikely that the Florida taxpayer would be entitled to a refund of FCIT related to a decrease in its Florida apportionment factor.

If the federal audit in the example above resulted in an adjustment to the taxpayer's petroleum sales revenue rather than additional depreciation expenses, however, a position may exist for the Florida taxpayer to claim a refund of FCIT based on the decrease in its Florida apportionment relating to the method of sourcing its Florida sales.<sup>33</sup>

### **Florida Voluntary Self-Disclosure Program**

Florida taxpayers may voluntarily self-disclose a Florida tax liability to the FDOR under F.S. §213.21(7). The FDOR is authorized under this statute to settle and compromise the self-disclosing taxpayer's unpaid tax and interest by limiting the amounts due to the three years immediately

preceding the date the taxpayer contacted the FDOR for the voluntary self-disclosure. In addition to the three-year period, the FDOR is authorized to further compromise tax and interest if it is in the best interests of the state under F.S. §213.21(7)(b). Some voluntary self-disclosures also qualify for a penalty compromise.<sup>34</sup> A Florida taxpayer is not entitled to enter into the program when the FDOR has contacted the Florida taxpayer about, or has begun an inquiry about, the taxpayer's liability.<sup>35</sup>

The voluntary self-disclosure program permits the initial contact to be made on an anonymous basis through a representative. This permits a Florida taxpayer's representative to negotiate the taxpayer's liability with the FDOR in advance of disclosing the taxpayer's identity to the FDOR, thereby allowing a taxpayer to explore the potential for a compromise before deciding whether to enter into the program. The name of the Florida taxpayer must be disclosed to the FDOR prior to the execution of the voluntary disclosure agreement (VDA). The disclosure can occur after the FDOR and Florida taxpayer's representative have agreed to the terms of the VDA.

Assuming a Florida taxpayer otherwise qualifies, the voluntary self-disclosure program can be used to report federal audit adjustments and may allow the Florida taxpayer to obtain a penalty compromise for failure to timely file amended FCIT returns. In addition, if the federal adjustments affect an item or items of Florida taxable income or apportionment, the treatment of which are uncertain under the Florida Corporate Income Tax Code, the Florida taxpayer's representative may potentially be able to negotiate a compromise of tax and interest to resolve the uncertain issue.

For example, assume that the IRS audited a Florida taxpayer for tax years ending December 31, 2005, through December 31, 2007. The items of adjustment relate to capital gains from sales of subsidiary corporations during the period. The

Florida taxpayer took nonbusiness income subtractions on its originally filed FCIT returns in each of these three tax years, resulting in a reduction in its Florida corporate income tax liability. However, the nonbusiness income subtractions could be challenged by the FDOR. Further, because the federal audit adjustments relate directly to the underlying capital gains, the FDOR can potentially assess additional FCIT for the nonbusiness income subtractions within five years after the Florida taxpayer files the required amended FCIT return, or at any time if no amended returns are filed.<sup>36</sup> In this example, the taxpayer could potentially use the voluntary self-disclosure program to report the federal audit changes as well as potentially compromise the uncertain nonbusiness income subtractions.

## Conclusion

A Florida taxpayer that is audited by the IRS should be aware that it may have a requirement to file amended FCIT returns to report federal audit changes. A Florida taxpayer may want to consider using the Florida voluntary self-disclosure program if additional FCIT is due and the federal adjustments reopen the statute of limitations relative to filing positions on the original return, which may be subject to FDOR challenge. To the extent that a Florida taxpayer is entitled to a refund of FCIT, the Florida taxpayer must accurately determine the 60-day due date by which amended returns would be due in order to timely file refund claims. □

<sup>1</sup> All references are to the Internal Revenue Code of 1986, as amended. The FCIT Code adopts the I.R.C. in effect January 1, 2015. FLA. STAT. §220.03(1)(n).

<sup>2</sup> FLA. STAT. §220.13(1)-(2).

<sup>3</sup> The revenue agent issues a report following the conclusion of an audit summarizing the adjustments to a taxpayer's federal income. This report is typically known as a "RAR."

<sup>4</sup> FLA. STAT. §95.091(3)(a)1.b.

<sup>5</sup> The Florida chief financial officer pursuant to FLA. ADMIN. CODE R. 691-44.020 delegated to the FDOR the authority to accept and process refunds of monies paid into the state treasury provided in FLA. STAT. §215.26(2).

<sup>6</sup> See note 32 relating to the payment

date of estimated tax.

<sup>7</sup> FLA. ADMIN. CODE R. 12C-1.023(3)-(4).

<sup>8</sup> FLA. STAT. §220.23(2)(c)3.

<sup>9</sup> FLA. STAT. §220.23(2)(c).

<sup>10</sup> A taxpayer may be entitled to interest provided in FLA. STAT. §213.255(4). Unlike underpayments of tax, interest on tax refunds does not begin to accrue until the 90th day after the FDOR has received a complete refund application.

<sup>11</sup> In the stated example, the additional FCIT is computed as follows: \$1,000,000 multiplied by 10 percent apportionment factor equals \$100,000 multiplied by 5.5 percent equals \$5,500.

<sup>12</sup> In the stated example, the refund of FCIT is computed as follows: \$500,000 multiplied by 10 percent apportionment factor equals \$50,000 multiplied by 5.5 percent equals \$2,750.

<sup>13</sup> FLA. STAT. §220.23(2)(a)3, FLA. ADMIN. CODE R. 12C-1.023(5). Florida law does not provide additional guidance on the meaning of this language, and as a consequence, application of this language to specific taxpayer facts may be challenging. A detailed discussion of FLA. STAT. §220.23(2)(a)3 is beyond the scope of this article.

<sup>14</sup> FLA. ADMIN. CODE R. 12C-1.023(5)(c).

<sup>15</sup> FLA. STAT. §220.23(2)(a); FLA. ADMIN. CODE R. 12C-1.023(5)(d).

<sup>16</sup> FLA. ADMIN. CODE R. 12C-1.023(5)(d).

<sup>17</sup> The IRS and taxpayer generally execute IRS Forms 870 (Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment) and 4549 (Income Tax Examination Changes) to resolve agreed-to items in a federal audit.

<sup>18</sup> 28 U.S.C. §2107(a)-(b). A notice of appeal for review must be filed within 30 days after the entry of a judgment, decree, or order of a U.S. district court. The time to file the notice of appeal by either party is 60 days instead of 30 days if the United States or an agency of the United States is a party.

<sup>19</sup> For purposes of this example, the final determination is assumed to occur when the IRS was entitled to collect the additional federal income tax following the expiration of the time to appeal the decision of the U.S. district court.

<sup>20</sup> See FLA. STAT. §§220.23(2)(a)3 (providing that an amended FCIT return must be filed within 60 days) and 220.801(1) (providing the FDOR authority to assess a penalty for a late filed return); FLA. ADMIN. CODE R. 12C-1.023(7).

<sup>21</sup> FLA. STAT. §220.23(2)(c)3.

<sup>22</sup> For purposes of this example, the Florida sales factor cannot be adjusted to include interest income, because the Florida taxpayer is not a financial organization as defined in FLA. STAT. §220.15(6). Generally, interest income is excluded from the Florida sales factor for nonfinancial organizations pursuant to FLA. STAT. §220.15(5)(a). If the Florida taxpayer was a financial organization, however, a basis may exist to adjust the Florida sales factor to include the interest under FLA. STAT. §220.15(5)(c)3-5.

<sup>23</sup> FLA. STAT. §95.091(3)(a)1.b.

<sup>24</sup> FLA. STAT. §220.222(1).

<sup>25</sup> FLA. STAT. §220.222(2).

<sup>26</sup> The general statute of limitations for assessments is extended an additional one year upon the issuance of a notice of intent to conduct an audit by the FDOR under FLA. STAT. §213.345.

<sup>27</sup> FLA. STAT. §220.23(2)(c)3. There appears to be no additional guidance in the Florida law regarding the scope of the phrase "after giving effect only to the item or items reflected in the adjustment," either with respect to assessments in FLA. STAT. §220.23(2)(c)3, or with respect to refunds in FLA. STAT. §220.23(2)(d). Therefore, there is some uncertainty whether, and to what extent, the FDOR may assess additional tax for a nonbusiness income subtraction when an item of capital gains is adjusted by a federal audit. A full discussion of this issue is beyond the scope of this article.

<sup>28</sup> See FLA. STAT. §220.717(1) (authorizing informal protests to proposed assessments), FLA. STAT. §72.011(1) (authorizing formal actions in the circuit court), and FLA. STAT. §§120.569, 120.57, and 120.80(14)(b) (authorizing formal actions in the Florida Division of Administrative Hearings).

<sup>29</sup> FLA. STAT. §220.23(2)(d).

<sup>30</sup> *Id.*

<sup>31</sup> FLA. STAT. §220.222(1).

<sup>32</sup> FLA. STAT. §220.727(1)(b) provides that "payments of estimated tax shall be deemed paid at the time such return is required to be filed under this code, determined with regard to an extensions of time allowed to the taxpayer under [§]213.055(2) or [§]220.222 for filing such return and not at such earlier time as such payments of estimated tax were actually made."

<sup>33</sup> FLA. STAT. §220.23(2)(d). See also note 27 regarding refunds.

<sup>34</sup> FLA. ADMIN. CODE R. 12-13.007(9) (providing that under certain circumstances the act of voluntary self-disclosure creates a presumption of reasonable cause grounds for compromise of penalties).

<sup>35</sup> FLA. STAT. §213.21(7)(a). A Florida taxpayer is also ineligible to participate in the program if it collected, but failed to remit, the tax to the state. FLA. STAT. §213.21(7)(d).

<sup>36</sup> See note 27 regarding assessments.

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