

Update on State Tax Conformity with the International Tax Provisions of the TCJA

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Panelists

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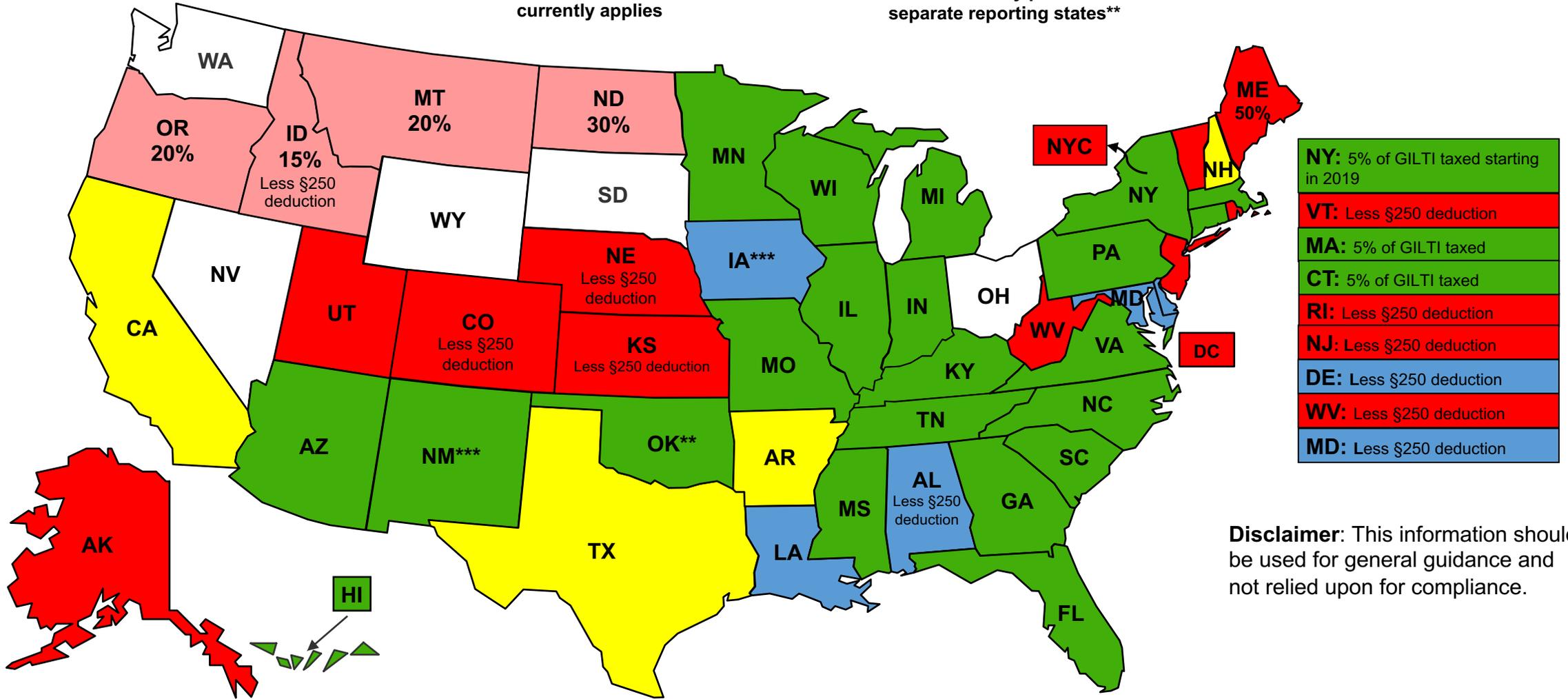
Agenda

- **Key International Tax Provisions Impacting the States**
- **Factor Representation and Constitutional Issues Relating to State Taxation of Foreign Source Income**
- **Future Direction of State Taxation of Foreign Source Income**

Key International Tax Provisions Impacting the States

State Corporate Income Tax Conformity to GILTI*

- State does not impose a corporate income tax
- Decoupled from GILTI (or excludes 95%)
- Have not addressed IRC conformity and/or GILTI coupling specifically. Neither GILTI nor § 250 deduction currently applies
- Potentially coupled to GILTI, but inclusion may be constitutionally prohibited in separate reporting states**
- Coupled or potentially coupled to 10% to 30% of GILTI**
- Coupled or potentially coupled to GILTI**



Disclaimer: This information should be used for general guidance and not relied upon for compliance.

Note: Those states with “less §250 deduction” only tax 50% of GILTI (or 62.5% after 2025).

* Based generally on 80% or more direct corporate ownership of foreign corporations. Other rules may apply for smaller % ownership or state personal income tax (PIT) purposes.

** GILTI is not specifically referenced in many state conformity statutes so some states may still decouple from some or all of GILTI by administrative/legislative action.

*** Iowa conformity begins in 2019. New Mexico decouples starting in 2020.

Source: Council On State Taxation

Is the Impact of GILTI the Same for State Tax Purposes as for Federal Tax Purposes?

- **Global (same)**: The starting point of federal and state GILTI (global intangible low-taxed income) is generally all of the global income earned by the taxpayer's foreign subsidiaries (after subtracting a 10 percent return on foreign fixed assets).

Is the Impact of GILTI the Same for State Tax Purposes as for Federal Tax Purposes?

- **Not Limited to Intangibles (same):** GILTI includes income from services, digital products, financial services, a sizable portion of tangible property sales, and intangibles.

Is the Impact of GILTI the Same for State Tax Purposes as for Federal Tax Purposes?

- **Low-Taxed (different):** The states do not conform to the (80%) foreign tax credit allowed for federal tax purposes to offset the GILTI income and limit the impact to “low-taxed” income.
- Counterpoint – Do they need to?

Is the Impact of GILTI the Same for State Tax Purposes as It Is for Federal Tax Purposes?

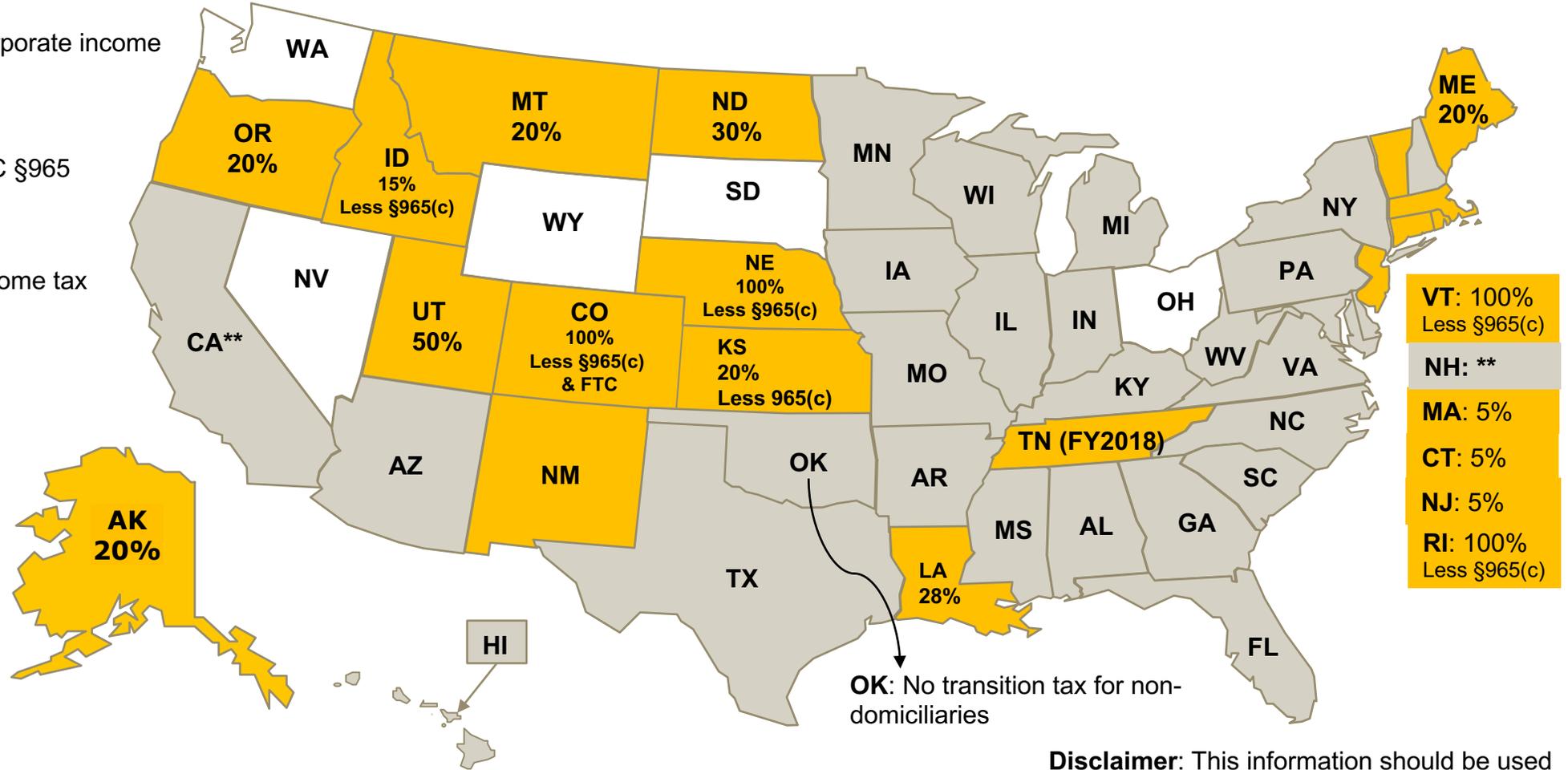
- **Offset by Corporate Tax Cuts (different):**
The states do not conform to federal corporate tax cuts (Congress is raising \$324 billion over 10 years from the international tax provisions to help pay for \$654 billion in business tax cuts).
- Counterpoint – Do states need to lower rates?

Is the Impact of GILTI the Same for State Tax Purposes as It Is for Federal Tax Purposes?

- **Domestic Commerce vs. Foreign Commerce (different):** The states are limited by the Constitution's Commerce Clause and cannot treat foreign commerce differently than domestic commerce.

One Time Issue: State Corporate Income Tax Conformity to IRC §965 Repatriated Income*

- State does not impose a corporate income tax
- 0%: State does not impose corporate income tax on IRC §965 repatriated income
- State imposes corporate income tax on some or all of IRC §965 repatriated income



* Based generally on 80% or more direct corporate ownership of foreign corporations. Other rules may apply for smaller % ownership or PIT purposes.

**No conformity update but taxes a portion of foreign dividends (when distributed) for water's edge filers.

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Source: Council On State Taxation

GILTI and Section 965 Income Compliance Issues from the Taxpayer Perspective

- Unclear statutory position and no public administrative guidance
- Guidance being issued very close to calendar year deadlines or even after calendar year deadlines
- Calculations in combined reporting states
 - Can calculations be done on a group basis or will any state require separate calculations within a combined group
 - Recalculations required where state group varies from federal, especially where it includes foreign entities
- Partnership issues for non-resident withholding/composite (e.g. GILTI not included on partnership return)

GILTI and Section 965 Income Compliance Issues from the State Perspective

- States were in the position of implementing ALL of TCJA, or decoupling from particular provisions – including issues involving a much broader class of taxpayers, and far less sophisticated taxpayers.
 - (And then there was *Wayfair* . . .)
- The IRS has only in the last six months begin to issue proposed regulations related to GILTI and the implementation of its provisions—which will inevitably affect how it is implemented at the state level.

Factor Representation and Constitutional Issues Relating to State Taxation of Foreign Source Income

Factor Representation: GILTI and IRC §965 Repatriated Income

- While most of the attention has been focused on state-by-state conformity to or decoupling from GILTI, a less noticed trend has developed regarding state guidance on the other key element of the state income tax equation: apportionment.

Factor Representation: GILTI and IRC §965 Repatriated Income

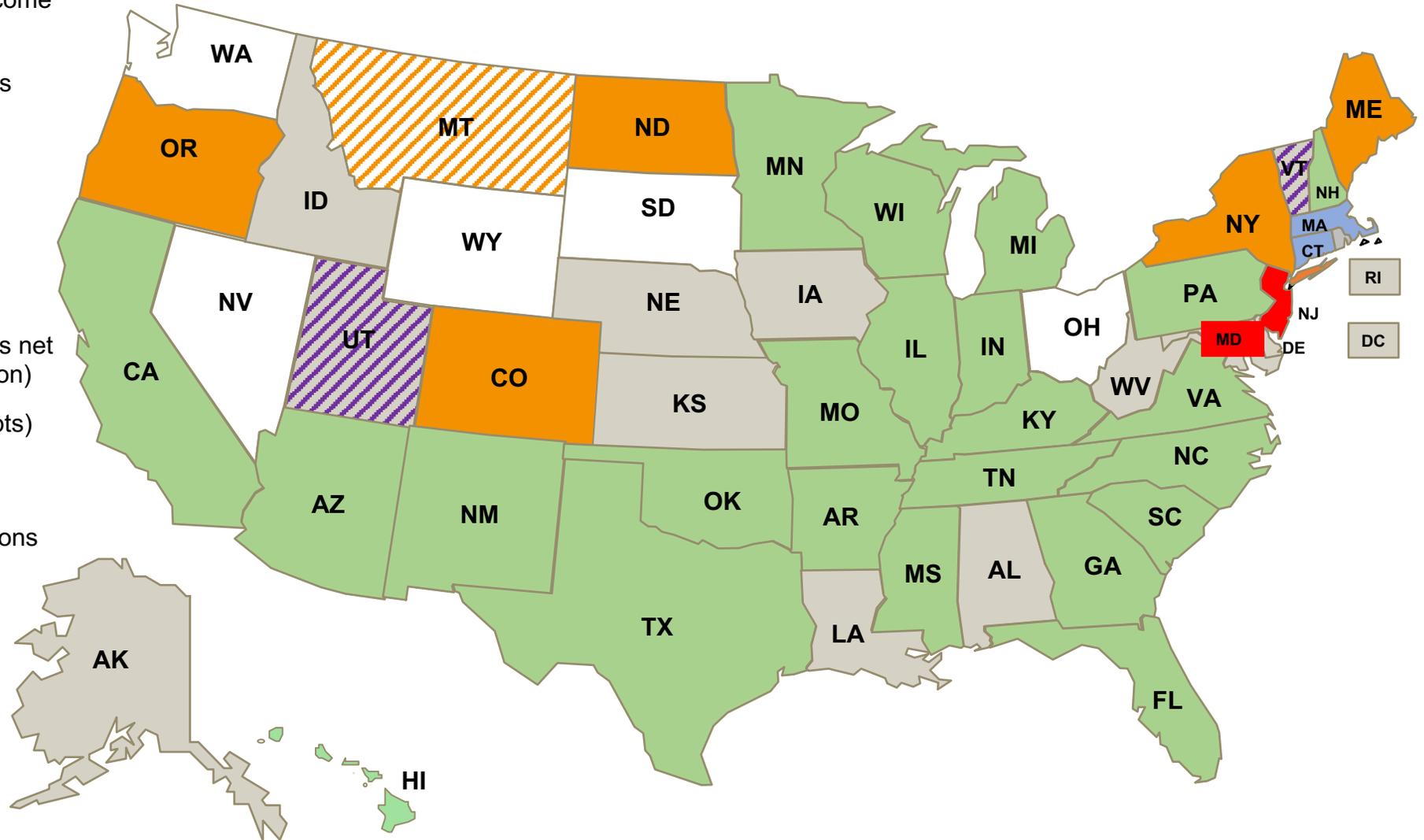
- The apportionment methodologies available to the states include:
 - No factor representation.
 - No specific guidance which can result in a taxpayer using its “domestic” factors to apportion GILTI/965 income or including its net GILTI/965 income in the denominator.
 - Net GILTI/ Section 965 income in the denominator.
 - Gross Receipts that produced the GILTI/ Section 965 income in the denominator.
 - Other
 - For example, New Jersey has adopted a unique apportionment methodology for GILTI and FDII based on the state’s share of US GDP. The formula does not allow inclusion of foreign factors nor of any other factors relating to the taxpayer’s business activity in the state.

Factor Representation: GILTI and IRC §965 Repatriated Income

- To date, the vast majority of the states provide no guidance on how to apportion GILTI/ Section 965 income or allow only the **net taxable foreign source income**, and not the gross receipts (or other factors) to be included in the denominators of the respective factors.

GILTI State Factor Representation*

- State does not impose a corporate income tax
- The state currently does not impose its corporate income tax on GILTI
- No factor representation allowed
- No new guidance
- Other methodology
- Sales factor denominator only includes net GILTI (after Sec. 250 or other deduction)
- Foreign factors (including gross receipts) relating to taxable income allowed in denominator(s)
- ⊘ Pattern indicates unofficial state positions (in appropriate colors)



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Source: Council On State Taxation

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Future Litigation over State Taxation of GILTI and IRC §965 Repatriated income

— **Separate reporting states: Can the foreign source income be taxed at all?**

- See *Kraft General Foods Inc. v. Iowa Department of Revenue*, 505 U.S. 71 (1992). A separate reporting state may not tax dividends from a controlled foreign corporation if it does not tax dividends from a controlled domestic corporation.
- Five separate reporting states (plus NJ in 2018) are still coupled to GILTI

Future Litigation over State Taxation of GILTI and IRC §965 Repatriated income

— **Combined reporting states: Can the foreign source income be taxed without appropriate factor representation (or a unitary relationship)?**

- Does the state taxation of GILTI (and IRC §965 Repatriated income) in combined reporting states violate Commerce Clause limitations unless appropriate foreign “factor representation” is allowed.
- This is not a new issue – the same issue arose in connection with how states apportion income from foreign dividends.
 - See *E.I. du Pont de Nemours & Co. v. State Tax Assessor*, 675 A.2d 82 (Maine 1996); and *Appeal of Morton Thiokol, Inc.*, 864 P.2d 1175 (Kan. 1993).

Future Direction of State Taxation of Foreign Source Income

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- Will more/fewer states tax GILTI?
- Will additional states enact “tax haven” legislation?
- Will any state enact legislation mandating worldwide combined reporting?
- Will states expand transfer pricing capabilities?
- Will any states follow the lead of France and impose a gross receipts-like tax on digital companies?
- Should states impose a corporate income tax on foreign source income when few other industrialized nations in the world do so at the subnational government level?