Update on State Tax Conformity with Federal Tax Reform

NESTOA Annual Meeting
September 11, 2019
Providence, Rhode Island

Presented by:

John Ficara, New Jersey Division of Taxation
Karl Frieden, Council On State Taxation
Agenda

- Key International Tax Provisions Impacting the States
- Factor Representation and Constitutional Issues Relating to State Taxation of Foreign Source Income
- Key Domestic Tax Provisions Impacting the States
Key International Tax Provisions Impacting the States
State Corporate Income Tax Conformity to GILTI*

* 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.

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

** 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.


Source: Council On State Taxation

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

Source: Council On State Taxation
Foreign Derived Intangible Income (FDII): IRC §250

— **General Overview**: Provides a 37.5% deduction (decreased to 21.875% after 2025) for certain income earned by a U.S. domestic corporation attributed to foreign sales relating to U.S. production.

  * FDII is calculated in a manner similar to GILTI. Returns in excess of 10% of fixed assets form the basis for the calculation.

— **State Tax Issues**:

  * Modest State Conformity – approximately one dozen states have conformed to FDII.
    
    * Selective decoupling – FDII, as enacted, is designed to work with GILTI.
  * The impact of FDII will be affected by a taxpayer’s state income tax filing method.
  * Apportionment: Is any special apportionment formula needed?
Factor Representation and Constitutional Issues Relating to State Taxation of Foreign Source Income
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.
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.

— New Jersey apportionment method for GILTI:
  • Initial apportionment methodology: NJ GDP over total GDP of all the U.S. states in which the company has economic nexus (TB-85(R))
  • Revised apportionment methodology: Net GILTI in the denominator of the receipts factor (TB-92).
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)

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

Source: Council On State Taxation

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

Key Domestic Tax Provisions Impacting the States
State Conformity to 30% Interest Expense Limitation

Enacted Legislation Decoupling from IRC §163(j) [Note – some of these states did not decouple as of 1/1/2018 but decoupled at a later date and some states may still have an intercompany interest expense adjustment]

For 2018 tax year – IRC adopted as of 1/1/2017 effectively decoupling from IRC §163(j)

Does not adopt IRC § 163(j) as of 1/1/18

Adopts IRC §163(j) and has general interest addback provisions

Source: Council On State Taxation

Disclaimer: This information should be used for general guidance and not relied upon for compliance.
Other State Tax Issues Related to the TCJA

— 100 Percent Expensing
  • The TCJA allows 100 percent expensing for most capital investments for 5 years; however, most states decouple from this provision just as the states decoupled from bonus depreciation.

— Net Operating Loss Limitations and Carryforwards
  • Numerous differences between Federal and State rules continue

— State Conformity with the Deduction for Pass Through Entities
  • Impact limited to a minority of states with PIT tied to federal “taxable income”

— Limitation of SALT deduction for state taxes paid to $10,000