The State Tax Implications of Federal Tax Reform Legislation

Executive Committee Task Force on State and Local Taxation
Phoenix, Arizona
January 14, 2017

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Prospects for Sweeping Federal Tax Reform

Favorable Factors
• Republican control of the Presidency and Congress
• Strong support of Speaker of the House Paul Ryan
• Compatibility with President-elect Trump’s trade and job creation policies
• The House Blueprint
• International tax pressures on the US

Potential Obstacles
• What happens in the Senate?
• Conflict over the border adjustability provision and other parts of the package
• Competition with other legislative priorities
• The mixed historical record of enacting comprehensive tax reform
# Federal Tax Reform: Impact on the States Based on Current IRC Linkage

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<th>States</th>
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<td>States have own rates, but conform to base broadening</td>
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State IRC Conformity: The Starting Point

Notes
AR – only specified sections adopted; various dates
AZ – 1/1/16
CA – 1/1/15
CT – last day of income year
FL – 1/1/16
GA – 1/1/16
HI – 12/31/15
IA – 1/1/16
ID – 1/1/16
IN – 1/1/16
KY – 12/31/15
MD – Current unless impact to state of $5MM or more
ME – 12/31/15
MI – 1/1/12
MN – 12/31/14
MS – current, but only specified sections adopted
NC – 1/1/16
NH – 12/31/00
OH – 4/1/15
OR – 12/31/15
PA – various provisions adopted current and FTI starting point.
SC – 12/31/15
TX – tax year beginning 1/1/07
VA – 12/31/15
VT – In effect for 2015
WI – 12/31/13
WV – 12/31/15

Current (Rolling)
Fixed Date
Does not incorporate the IRC by reference, but uses Federal Taxable Income as the starting point
Conforms only to specified sections
No corporate income tax – N/A
Examples of State Non-Conformity with the Internal Revenue Code

- IRC 168(k) provided **bonus depreciation** for eligible property purchased between 2002 and 2020
  - Was originally passed in 2002 as part of the Job Creation and Worker Assistance Act and was last amended with 2015’s Protecting Americans from Tax Hikes Act (PATH Act)
  - 15 states conform with 168(k)
  - **31 states do not conform** with 168(k)

- IRC 179 provides for **first-year expensing** of small business capital investment, currently set at up to $500,000
  - 46 states generally conform with IRC 179 expensing
  - **11 states do not conform with IRC 179 expensing limits**, instead imposing lower limits, ranging from $25,000 to $250,000
Fiscal Impact on the States

• States do not generally conform to some of the Blueprint’s major revenue loss provisions:
  – Corporate, personal income, flow through entity, and unearned income tax rate reductions.

• States are likely to receive significant revenue increases from conformity with other Blueprint provisions:
  – Border adjustability; disallowance of interest deductions; elimination of many corporate and personal income tax deductions

• Will some states opt out of certain revenue losing provisions (e.g. expensing of investments), even though the aggregate impact is likely to result in a revenue increases.

• What will the states do with potential revenue windfalls
  – Based on current state conformity with the IRC, there is likely to be a revenue windfall for the states if the Blueprint passes.
  – Will states reduce rates or otherwise attempt to make the overall impact revenue neutral?
Lessons from the Past: Differences with the Tax Reform Act of 1986

• The 1986 Act took several years to enact – but the Presidency and Congress were in different party control.

• The 1986 Act was focused more on rate reductions and base broadening, not on more transformative changes such as the shift from a “origin-based” net income tax to a “destination-based” cash flow tax; and a shift to territorial taxation.

• The 2017 federal tax reform package will have significant implications for states sales tax.
  – What happens if the federal government shifts its income tax to a more consumption tax-base approach?
2016 Post-Election State Legislative Control

Source: National Conference of State Legislatures

* WA - Republicans will have functional control as one Democrat will caucus with the Republicans.