



# State responses to tax reform



# Federal tax reform- an overview

H.R. 1 signed into law December 22, 2017

— Included elements of the House and Senate versions of the bills

- Not many surprises in conference agreement, but will likely be many unintended consequences as taxpayers further evaluate H.R. 1

Most sweeping tax reform since the Tax Reform Act of 1986

— But, key differences exist between the 1986 tax reform process and 2017

- 1986 Tax Reform was a two-year process with a fair degree of visibility into the process
- Final bill was revenue neutral, but shifted burden from individuals to corporations
- Did not include international reforms to the degree that 2017 reform does

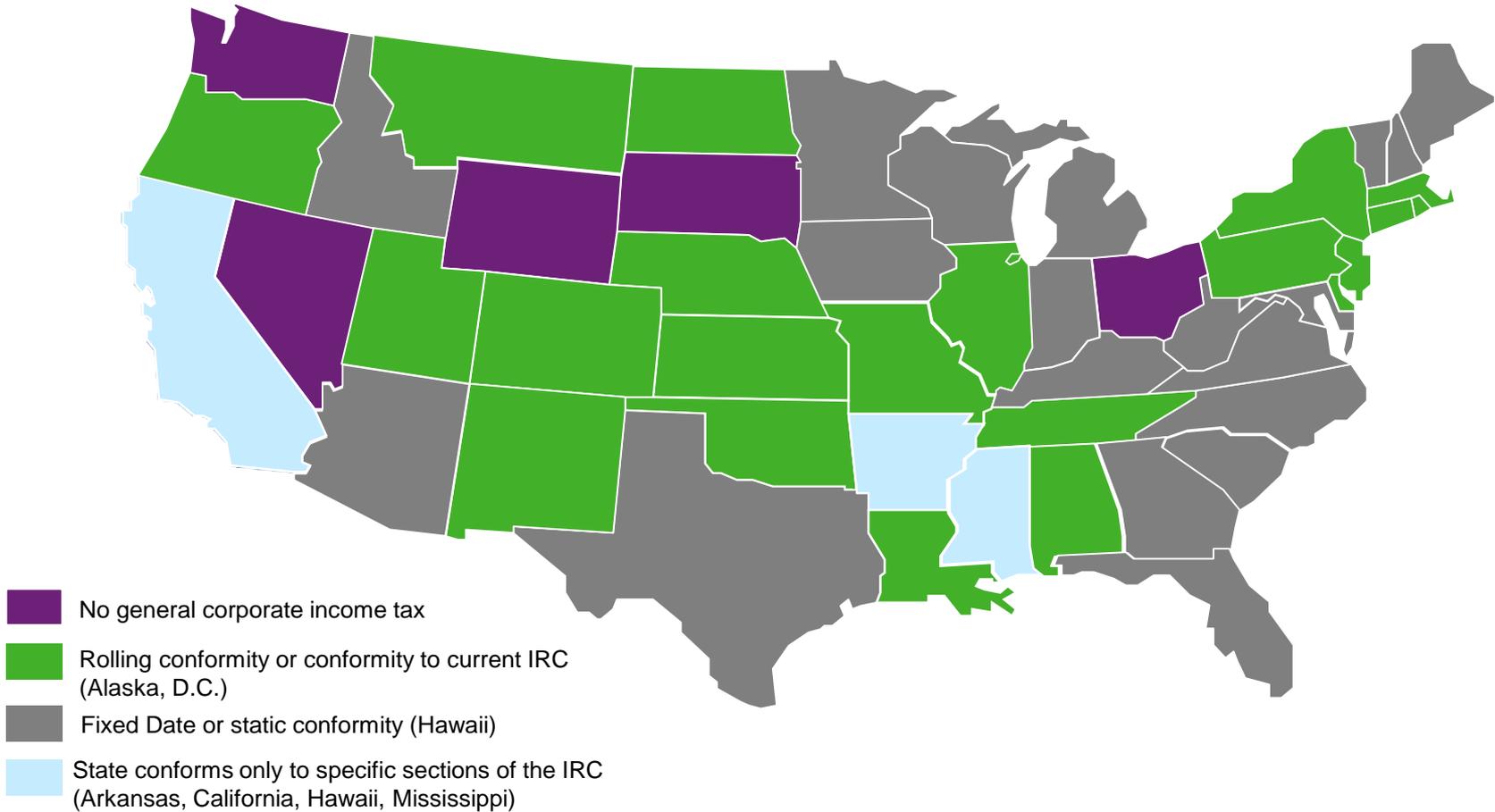
# State conformity to the IRC

States generally conform to the IRC in one of two ways

- “Moving” or “rolling” conformity states adopt the IRC as currently in effect for the tax year in question
  - All federal changes will be automatically incorporated into the state’s law unless a specific decoupling modification is enacted or the state changes its conformity to fixed
- “Fixed-date” or “static” conformity states conform to the IRC as of a certain date
  - For example, if a state conforms to the IRC as of January 1, 2015, the state does not adopt any federal tax changes that occurred after that date that would go into the computation of “federal taxable income”
  - The fixed-date states typically update each year

There are other states that update only periodically (e.g. CA, NH) and/or adopt only certain sections of the Code (e.g., AR, CA, HI)

# General state conformity to the IRC



# Key changes affecting corporations

## Few conformity issues

**Corporate rate reduction to 21 percent**

**Repeal of corporate AMT**

**Repealing/revising certain miscellaneous deductions**

**Changes to IRC section 1031 like kind exchanges**

**Base Erosion Anti-abuse Tax or BEAT**

## Complex conformity issues

**Mandatory repatriation**

**New GILTI inclusion/ Foreign Derived Intangible Income**

**Limits on net interest deduction**

**100 Percent bonus depreciation**

**Limits on use of NOLs**

**Taxation of state/local contributions to capital**

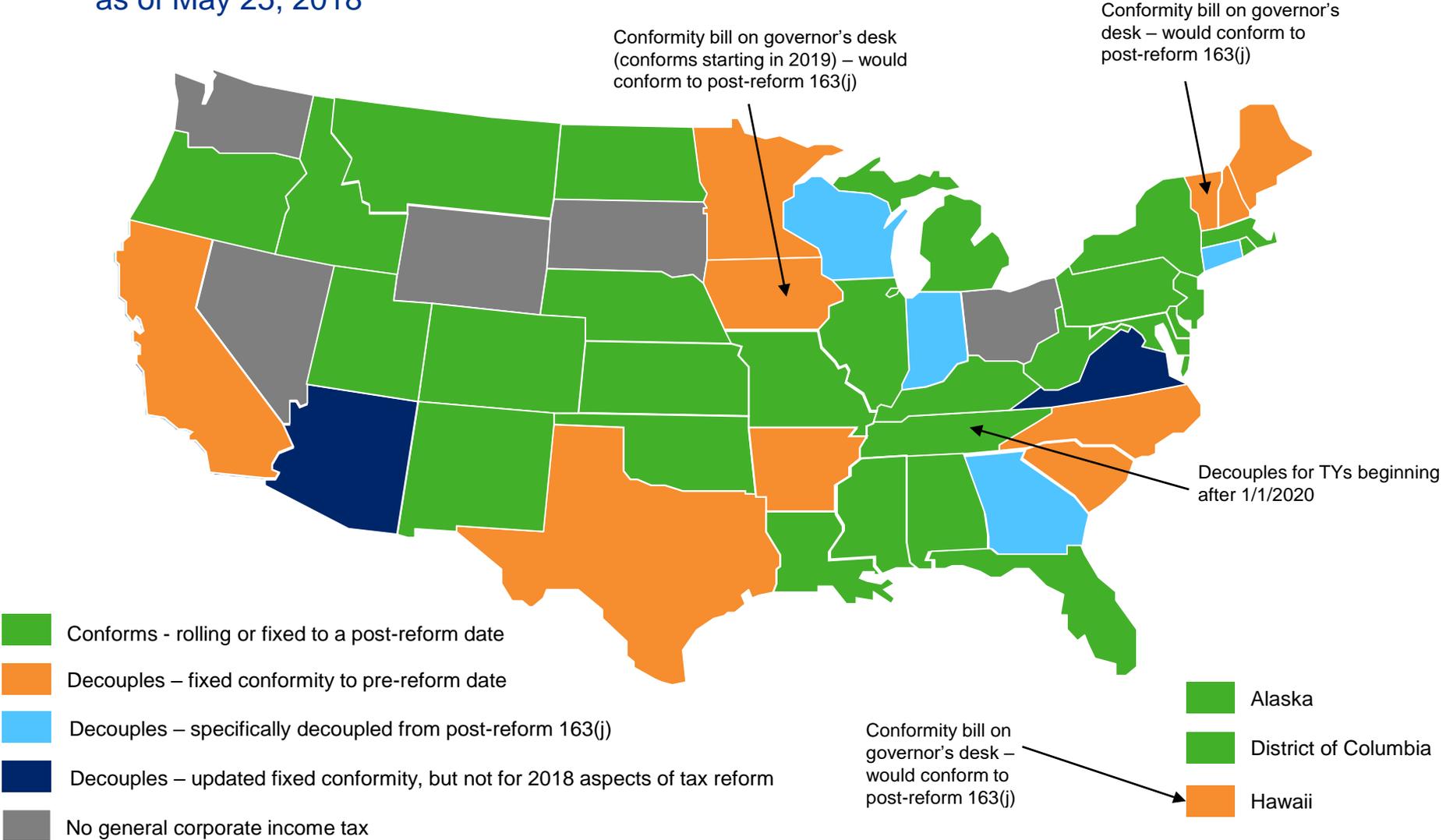


# State Responses to Federal Tax Reform

- At this point, many state legislative sessions have adjourned and almost all the “fixed-date” states have enacted legislation to update their conformity to the Code
  - Three general approaches
    1. Blind adoption to the Code post- tax reform
    2. Adopting a conformity date post-tax reform, but decoupling from certain (in some cases many) tax reform provisions
    3. Adopting a conformity date pre-tax reform
- The fixed-date states that have not acted at all include AR, CA, NH, and TX
  - Minnesota’s Governor vetoed conformity bill; Maine and South Carolina failed to pass legislation during their regular sessions; North Carolina’s session just convened

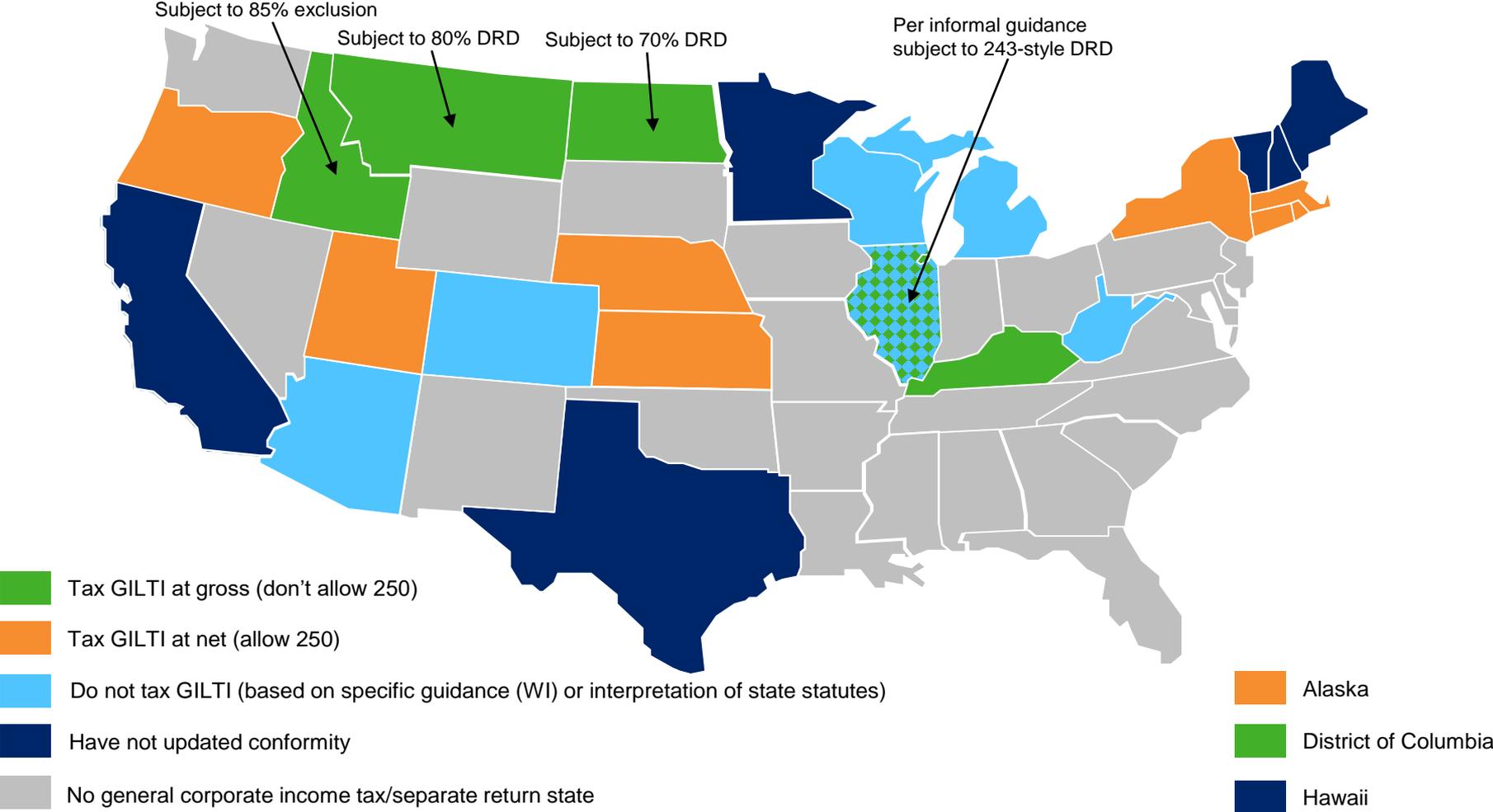
# State conformity to post-reform 163(j)

as of May 25, 2018



# Unitary State taxation of GILTI (as of 5/24/18)

Not considering Foreign Commerce Clause arguments



# Other tax reform related legislation

## **Oregon Senate Bill 1528 (signed April 13, 2018)**

- Requires an addback for amounts deducted under IRC section 199A

## **Utah House Bill 244 (signed March 22, 2018)**

- Allows a taxpayer that makes an election under IRC section 965(h) to likewise pay the Utah tax on mandatory repatriation over eight years

## **Pennsylvania House Bill 2017 (passed House March 14, 2018)**

- After the Tax Cuts and Jobs Act was signed, the Department of Revenue issued Corporation Tax Bulletin 2017-02, which decoupled from 100 percent bonus depreciation but provided no additional mechanism for cost recovery
- For assets placed in service after September 27, 2017, House Bill 2017 would allow a deduction equal to the depreciation as determined in accordance with IRC section 167 and 168

## **Illinois Senate Bill 3152 (passed April 26, 2018)**

- Would require corporations to add back amounts deducted for foreign derived intangible income

# Other tax reform related legislation

## **New York Assembly Bill 9509 and Senate Bill 7509 (signed April 12, 2018)**

- Under New York law, entire net income, minus net investment income and net other exempt income, subject to certain modifications, equals a taxpayer's business income  
"Other exempt income" means the sum of exempt Controlled Foreign Corporation (CFC) income and exempt unitary corporation dividends. The budget bills:
  - Expands the definition of exempt CFC income to include income required to be included within a taxpayer's federal gross income under IRC section 951(a) by reason of IRC section 965(a) without regard to IRC section 965(c) that are received from a corporation not included in a combined report with the taxpayer
  - Disallows the deduction under 965(c) and the federal deduction under 250 that results in FDII being taxed at a beneficial rate
  - Does not address GILTI
  - Adopts an elective "employer compensation expense program" (payroll tax) that would shift a portion of the individual income tax to a tax on a business entity that continues to be allowed as a deduction to the business for federal purposes
  - Authorizes creation of charitable contribution funds to which NY taxpayers can make charitable contributions and in return receive an individual income tax credit for a portion of the contribution

# Other tax reform related legislation

## Connecticut Senate Bill 11 (pending signature)

- Adopts a new, mandatory entity-level tax imposed on partnerships and S corporations doing business in the state
  - This new tax is effective for tax years commencing on or after January 1, 2018
- Effective for income years commencing on or after January 1, 2017, expenses related to dividends will equal five percent of all dividends received by a company during an income year
  - Taxpayers are not allowed a deduction for expenses related to dividends
- Decouples from certain federal tax reform provisions- note that Connecticut is a rolling conformity state
  - Provides a deduction for the amount of any contribution made by the state of Connecticut or its political subdivisions to the extent included in gross income under IRC section 118(b)(2)
  - The limits on the deductibility of interest under I63(j) do not apply
  - Requires corporations to add back eighty percent of deductions claimed under IRC section 179; Connecticut had already decoupled from bonus depreciation

# Other tax reform related legislation

## **Tennessee Senate Bill 2119 (signed May 21, 2018)**

- Adopts the federal limits on net interest expense deductions- until 2020
  - Effective for tax years beginning on or after January 1, 2020, IRC section 163(j) shall be applied as it existed before the enactment of the Tax Cuts and Jobs Act of 2017
- Allows a corporate taxpayer a deduction from net earnings and losses for any amount that the taxpayer would have excluded from federal taxable income as a result of applying IRC section 118 of as it existed immediately before enactment of the Tax Cuts and Jobs Act

# General thoughts on tax reform responses

## **Certain states did—on a more modest note— try to "mirror" the federal rate reduction**

- Many states adopted modest tax rate reductions for individuals and/or corporations, which wasn't necessarily expected

## **Much work left to do**

- Many states still have work to do to formulate how they will handle or whether they will adopt tax reform changes
  - Florida required to obtain public input on corporate tax reform changes and examine how the state's corporate tax laws will be affected; must report to legislature by February 1, 2019
  - Certain states, like AZ and VA, have not yet dealt with Tax Cuts and Jobs Act for 2018

## **Guidance, guidance and more guidance**

- At this juncture, most state-issued guidance has been related to state treatment of amounts included in income under IRC section 965
- Not surprising, but there's a lot to address before 2018 compliance begins



Thank you



# Appendix

## States that Conform to Federal Bonus Depreciation (IRC Section 168(k), The Federal NOL Limitation (IRC Section 172), and Business Interest Deduction Limitation (IRC Section 163(j))

- **The following slides outline those states that have taken legislative action to adopt the respective provision in the Tax Cuts and Jobs Act (Public Law 115-97) or have rolling conformity to the Internal Revenue Code and adopt the respective provision.**

## States that Conform to Federal Bonus Depreciation (IRC Section 168(k), The Federal NOL Limitation (IRC Section 172), and Business Interest Deduction Limitation (IRC Section 163(j))

Conformity to the IRC	State	IRC section 168(k) (Bonus Depreciation)	IRC section 172 (NOL Limitation)	IRC section 163(j) (Business Interest Deduction Limitation)
Rolling	Alabama	✓		✓
Rolling	Alaska	✓		✓
Rolling	Colorado	✓		✓
Rolling	Delaware	✓	✓	✓
Rolling	District of Columbia			✓
Fixed	Florida			✓
Fixed	Georgia	✓	✓	
Fixed	Hawaii		✓ (conformity bill on Governor's desk that would conform to 172)	✓ (conformity bill on Governor's desk that would conform to 163(j))
Fixed	Idaho			✓
Rolling	Illinois	✓ (partially, but in a way that 100% bonus depreciation is allowed)		✓
Fixed	Iowa			✓ (conformity bill on Governor's desk that would conform to 163(j) starting in 2019)
Rolling	Kansas	✓	✓	✓

## States that Conform to Federal Bonus Depreciation (IRC Section 168(k), The Federal NOL Limitation (IRC Section 172), and Business Interest Deduction Limitation (IRC Section 163(j))

Conformity to the IRC	State	IRC section 168(k) (Bonus Depreciation)	IRC section 172 (NOL Limitation)	IRC section 163(j) (Business Interest Deduction Limitation)
Fixed	Kentucky		✓	✓
Rolling	Louisiana	✓		✓
Fixed (because of one year delay if MD effect is over \$5 million)	Maryland	✓ (largely does not conform except for property placed in service by a manufacturing entity on or after January 1, 2019)		✓
Rolling	Massachusetts			✓
Fixed (but Taxpayer can elect to use the current IRC)	Michigan			✓
Rolling	Mississippi			✓
Rolling	Missouri	✓	✓	✓
Rolling	Montana	✓		✓
Rolling	Nebraska	✓ (except that in some past taxable years, bonus depreciation is partly delayed)	✓	✓
Rolling	New Jersey			✓

## States that Conform to Federal Bonus Depreciation (IRC Section 168(k), The Federal NOL Limitation (IRC Section 172), and Business Interest Deduction Limitation (IRC Section 163(j))

Conformity to the IRC	State	IRC section 168(k) (Bonus Depreciation)	IRC section 172 (NOL Limitation)	IRC section 163(j) (Business Interest Deduction Limitation)
Rolling	New Mexico	✓		✓
Rolling	New York			✓
Rolling	North Dakota	✓		✓
Rolling	Oklahoma	✓		✓
Fixed	Oregon	✓		✓
Rolling	Pennsylvania			✓
Rolling	Rhode Island	✓	✓	✓
Rolling	Tennessee			✓ (Decouples for TYs beginning after 1/1/2020)
Rolling	Utah	✓		✓
Fixed	Vermont			✓ (conformity bill on Governor's desk that would conform to 163(j))
Fixed	West Virginia	✓	✓	✓



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