

# **State Tax Implications of Federal Tax Reform (and Other Federal Influences Pressing on State Taxation)**

**Federation of Tax Administrators Annual Meeting  
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# AGENDA

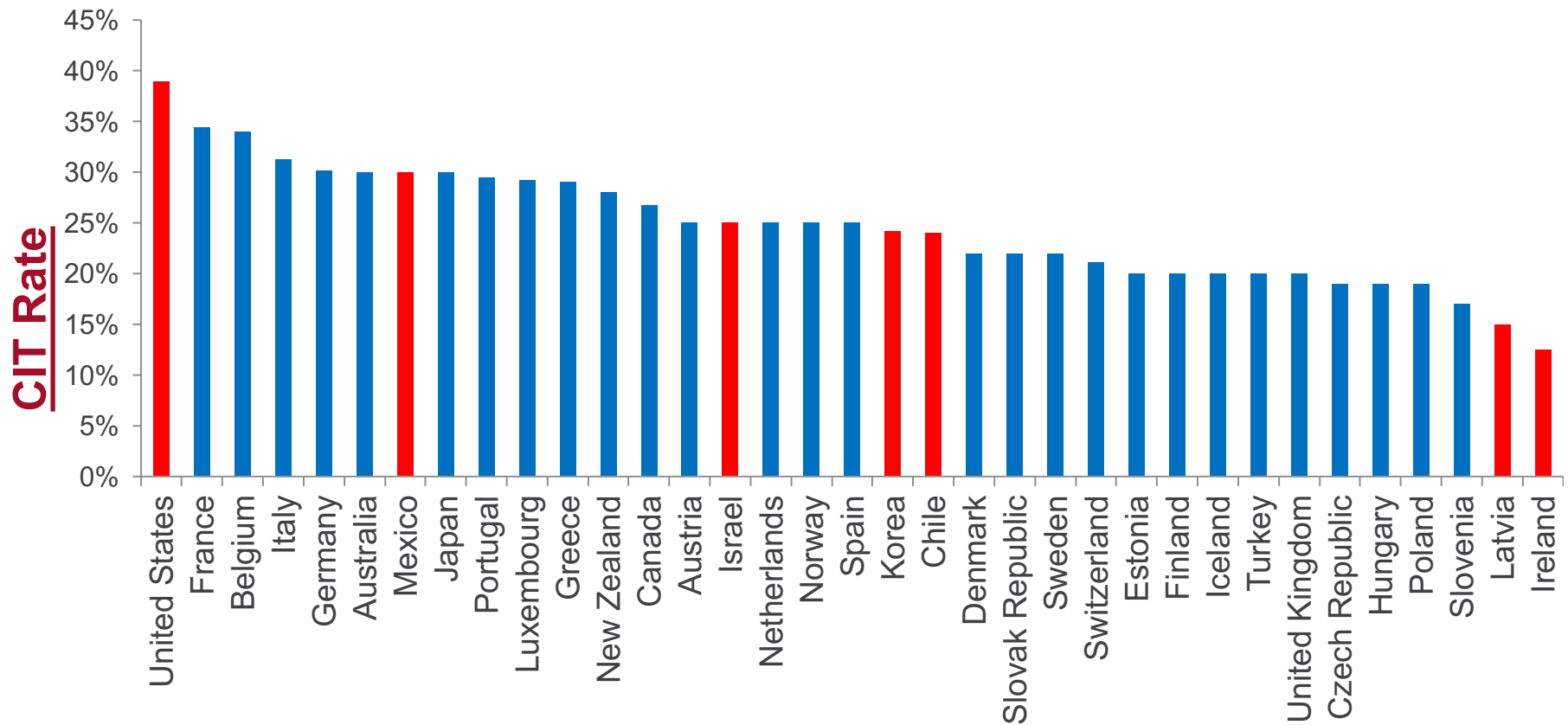
- The Economic and Political Landscape for Comprehensive Federal Tax Reform
- State Tax Implications of Federal Tax Reform
- Key State Tax and Fiscal Impacts
- Discussion with State Tax Administrators



# The Economic and Political Landscape for Comprehensive Federal Tax Reform

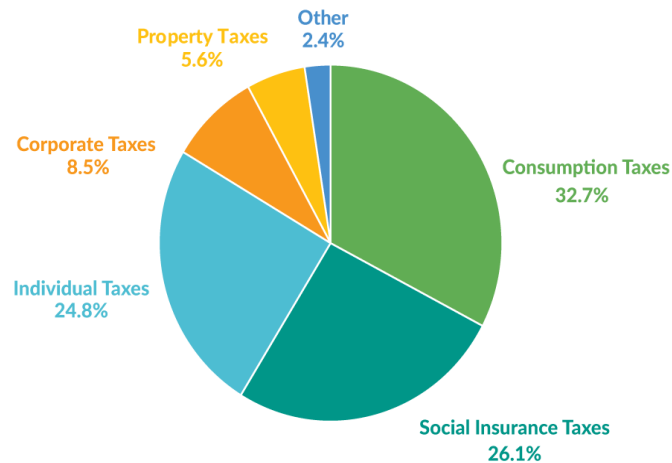
# US Income Tax System Out of Step with Rest of the World

Worldwide Taxation  
Territorial Taxation



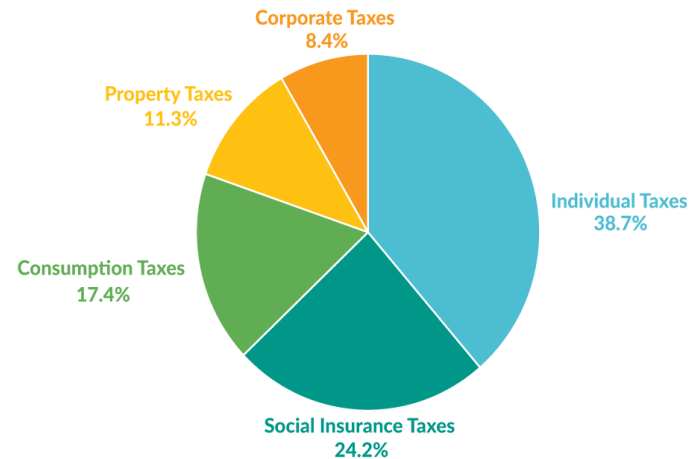
# The U.S. Relies Less on Border Adjusted Consumption Taxes: 33% OECD vs. 17% US

OECD Average Sources of Tax Revenue, 2013



Source: OECD.StatExtrats, <http://stats.oecd.org/>

United States' Sources of Tax Revenue (Federal, State, and Local, 2013)



Source: OECD.StatExtrats, <http://stats.oecd.org/>

# Prospects for Federal Tax Reform in 2017

## **Favorable Factors**

- Comprehensive tax reform is a top priority of the Republican party that now controls the Presidency and Congress
  - Compatibility with President's trade and job creation policies
  - Strong support of Speaker of the House Paul Ryan
- International tax pressures on the US
- Pressure for a legislative win

## **Potential Obstacles**

- The divisions within the Republican party that were on display in the failed (so far) ACA repeal
- Differences between the House Blueprint, President Trump's tax reform proposals, and Senate perspectives
- Different priorities within the U.S. business community
- Potential opposition from state and local governments
- The complexity of enacting comprehensive federal tax reform legislation

# State Tax Implications of Federal Tax Reform

# Comparison of House Blueprint and Trump Proposal

Provision	Current Law	House GOP 2016 Tax Reform 'Blueprint'	Trump April 26 Proposal
<b>Corporate tax rate (federal)</b>	35% rate	20% rate	15% rate
<b>International tax regime</b>	'Worldwide' system with deferral Foreign tax credits to mitigate double taxation	'Territorial' system 100% dividend exemption system	Territorial system
<b>"Deemed" repatriation</b>	n.a.	Previously untaxed foreign earnings: 8.75% tax rate for cash and cash-equivalents; 3.5% tax rate for non-cash assets.	Previously untaxed foreign earnings taxed at low rate (TBD)
<b>Border Adjustment</b>	n.a.	Border adjustment of corporate tax	Not included in proposal
<b>Cost recovery (full expensing)</b>	Recover over the investment's applicable life (50% bonus depreciation for equipment in 2017,)	Full expensing for depreciable and amortizable investments (tangible and intangible)	Not included in proposal
<b>Business interest expense</b>	Deductible as incurred	Deductible only against net interest income Special rules for financial services	Not included in proposal
<b>Base Broadening</b>	n.a.	Extensive base broadening by limiting PIT and CIT deductions and credits	Extensive base broadening by limiting many PIT and CIT deductions and credits
<b>Top individual tax rate</b>	39.6% plus 3.8% ACA tax, plus 1.2% phase out of itemized deductions	33% rate	35% rate
<b>Pass-through businesses</b>	Taxed at individual rates	Taxed at individual rates not to exceed 25%	15% rate



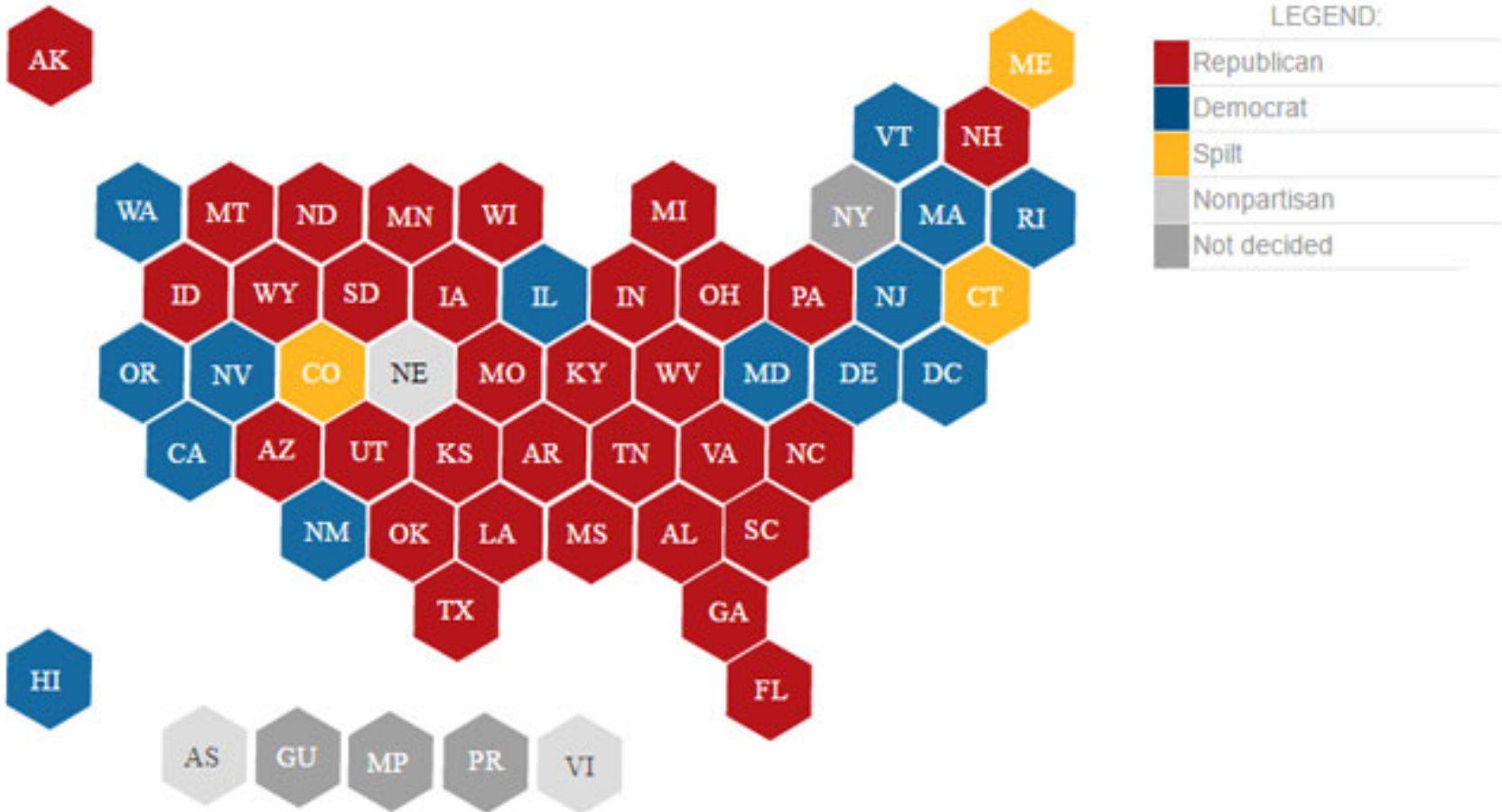
# Federal Tax Reform: Impact on the States Based on Current IRC Linkage

Federal	States
▶ Reduce the top corporate income tax (CIT) rate	▶ States have own rates
▶ Broaden the CIT tax base	▶ State conformity
▶ Border adjustability	▶ State conformity
▶ Denial of interest deduction	▶ State conformity
▶ Expensing investments	▶ State partial conformity
▶ Reduced repatriation rate	▶ Modest impact
▶ Territorial tax regime	▶ Minimal conformity
▶ Reduce flow-through rate	▶ States have own rates
▶ Other personal income tax changes	▶ States have own rates, but generally conform to base broadening





# The Political Road Map: 2016 Post- Election State Legislative Control



Source: National Conference of State Legislatures

# Key State Tax and Fiscal Impacts

# Federal Budgetary and Other Effects

- Blueprint purports to be revenue neutral (using ‘dynamic’ scoring); President’s principles do not address revenue consequences
- Deficit financing of tax cuts will impose fiscal constraints on federal government and its ability to finance intergovernmental programs
- Other proposals simultaneously shifting responsibilities to states or constraining resources
  - Medicaid financing
  - Repeal of deduction for state and local taxes
    - Accounts for about \$1.8 trillion (over 10 years) of the \$2.3 trillion PIT base broadening at the federal level.
    - Increases the after-tax costs of state and local government at a time when federal resources will be constrained
- Repeal of exclusion for state and local bond interest would increase the cost of state and local government financing.
- Radical change in entity-level tax base
- Change of such magnitude as to raise questions of continued conformity in certain areas
- Moves federal government into competition with states for consumption tax base

# What to Expect from States?

- Prospects for state reductions in rates is unclear (at best)
  - Any state base broadening likely to be relatively less than at federal level because of lack of conformity and other issues
  - State fiscal conditions may not allow for it, and deficit financing not allowed
    - Many states experiencing fiscal difficulties at the present time
    - Impact of reform is to further restrain resources and increase responsibilities
  - Limited pressure for state reductions in pass-through rates unless they also reduce regular corporate rate
    - “Dynamic scoring” is a wild card for states
- Change may be of sufficient magnitude and uncertainty
  - Freeze things in place in near-term
  - Move to a stand-alone gross receipts tax in the long-term

# Discussion with State Tax Administrators



# Discussion with State Tax Administrators

- What is the level and type of work that has gone on in your state in terms of thinking about and analyzing the proposed reforms?
- Of the various proposals, which ones do you think are most important or challenging for the states? Why, and how do you see those provisions playing out at the state level?
- How do you think the destination based cash flow tax as laid out in the House GOP Blueprint would affect your state?
- How does your state conform to the IRC for individual income taxes? Have you done any assessment of the potential impact of the federal proposals (essentially repeal itemized deductions (except for mortgage interest and charitable contributions), increase the standard deduction and repeal personal exemption allowances, and reduce rates)? Do you think this would be a net increase in the base or a net decrease?
- What is the overall fiscal condition in your state, in terms of budget balance?
- What did your state do following the enactment of the 1986 federal reform?