



# **The State Tax and Budget Implications of Federal Tax Reform**

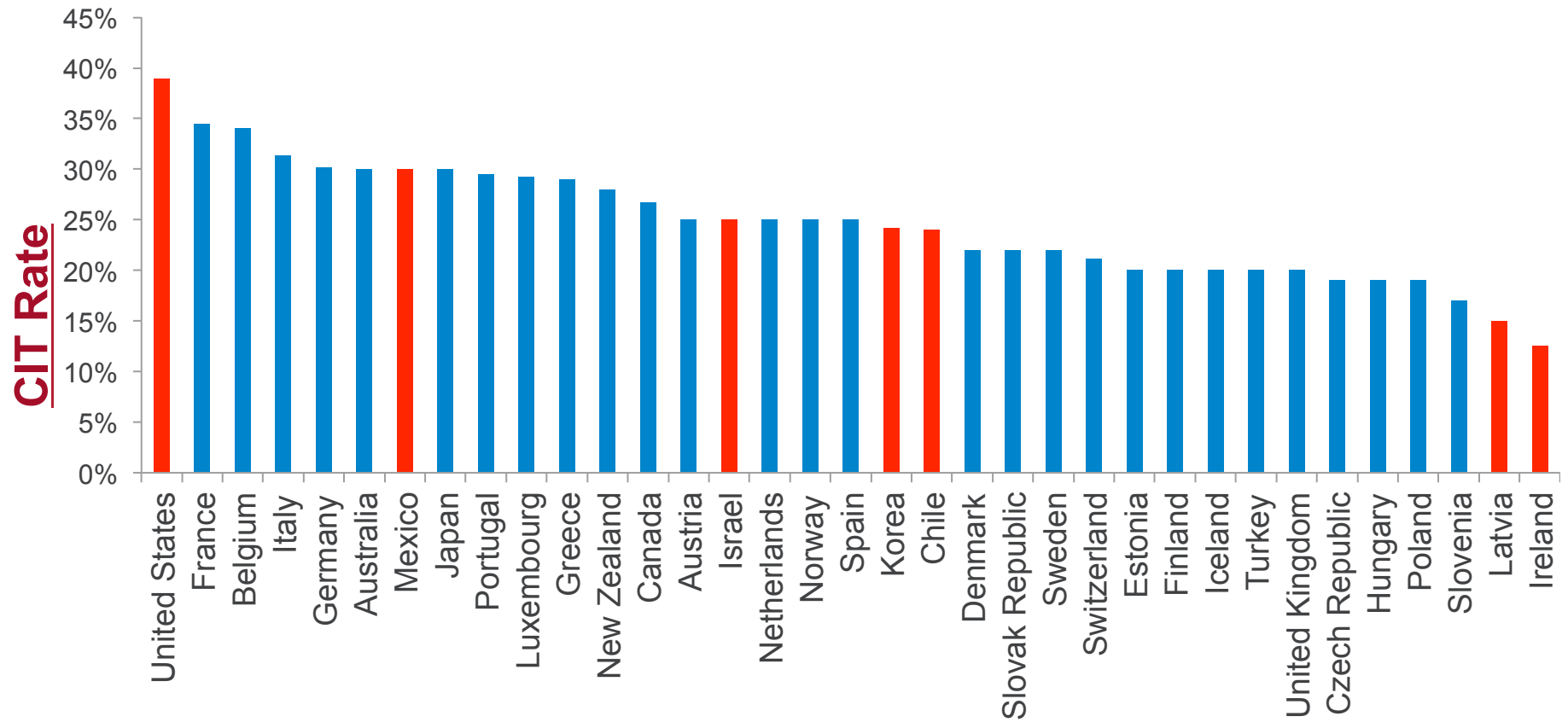
**Federation of Tax Administrators  
Revenue Estimating Conference  
Omaha, Nebraska  
September 26, 2017**

**Karl Frieden, VP & General Counsel,  
Council On State Taxation**

# The Drivers of Comprehensive Federal Tax Reform

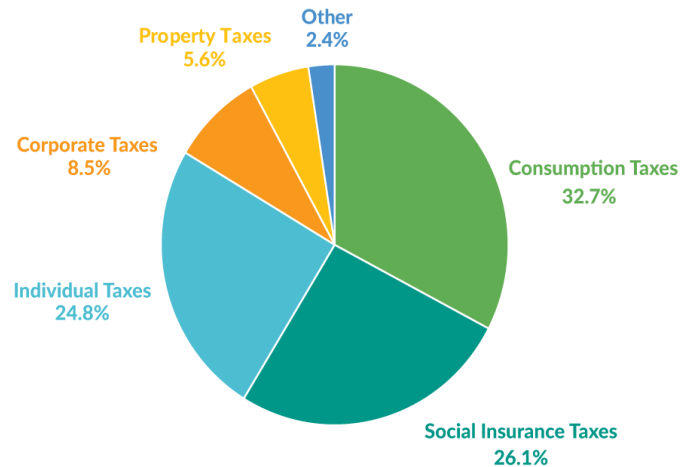
# Improve the International Competitiveness of the U.S. Income Tax System

Worldwide Taxation  
Territorial Taxation



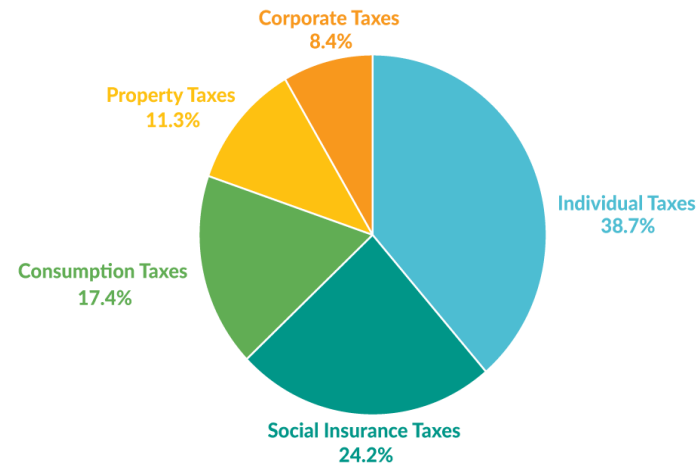
# Increase U.S. Reliance on Consumption Tax-Like Principles. Share of Consumption Taxes: 33% OECD vs. 17% US

OECD Average Sources of Tax Revenue, 2013



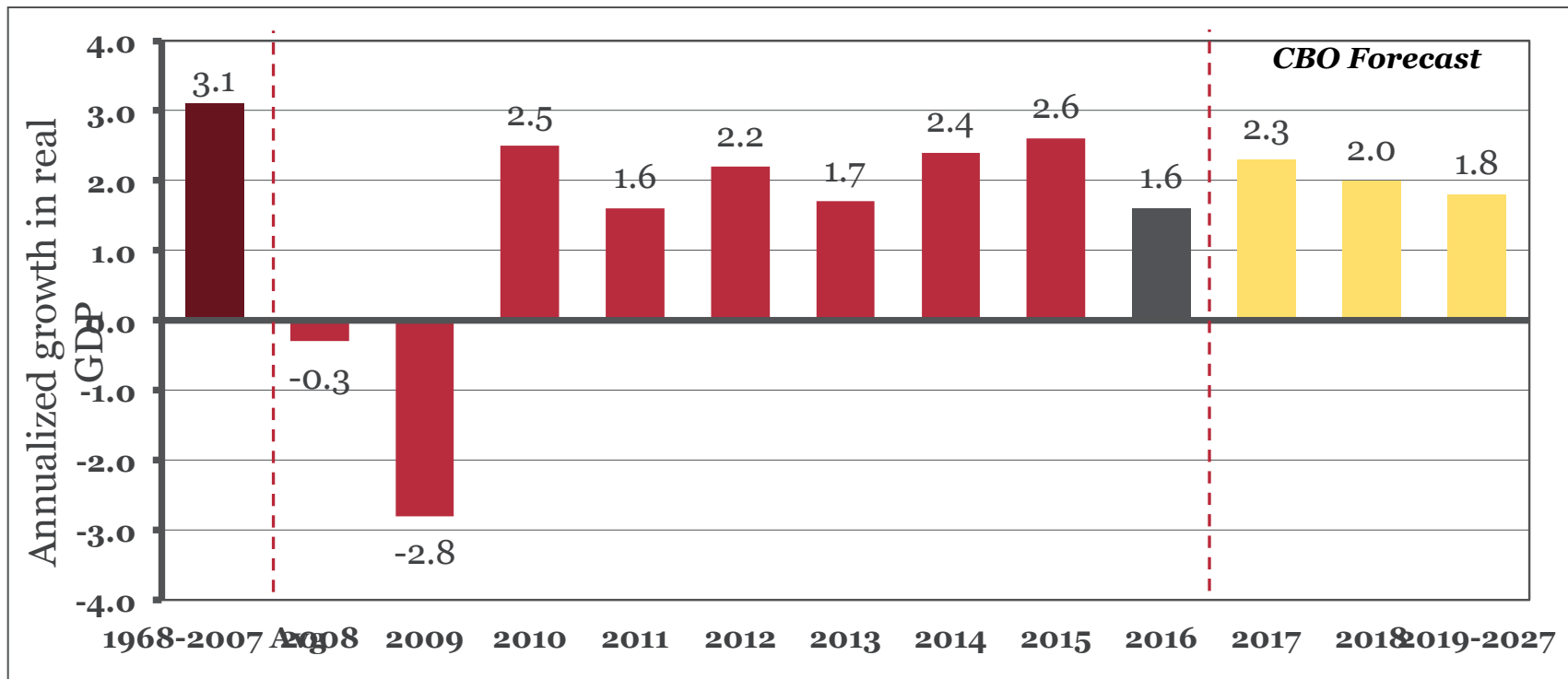
Source: OECD.StatExtrats, <http://stats.oecd.org/>

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



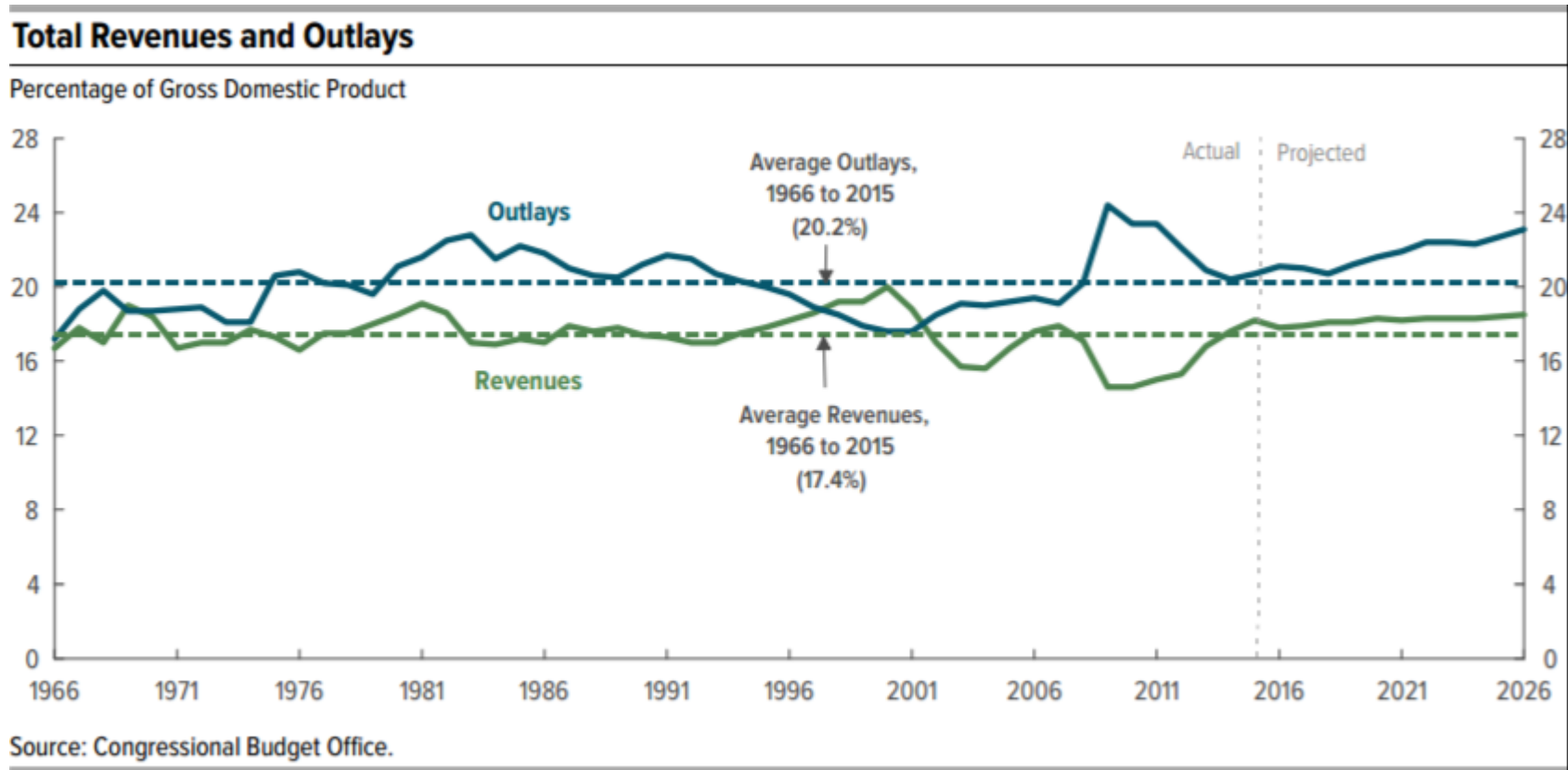
Source: OECD.StatExtrats, <http://stats.oecd.org/>

# Accelerate U.S. Growth



Source: Bureau of Economic Analysis, January 2017.

# The Major Constraint: Long-term Federal Budget Outlook



# State Tax and Budget Implications of Federal Tax Reform

# Three Federal Tax Reform Concepts in One

- **Business and personal income tax rate cuts and base broadening**
  - A potential cap on the PIT rate for flow through entities.
  - The possible curtailment/elimination of the state and local tax deduction
- **Territorial taxation and “deemed” repatriation**
- **Transformative proposals:**
  - Full expensing, business interest expense, border adjustments (off the table)



# 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 (But no longer included)
▶ Denial of interest deduction	▶ State conformity
▶ Expensing investments	▶ State 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

# Key Issues to Watch For in the Federal Tax Reform Debate

- Will any significant tax reform be enacted?
- Reconciliation process or bi-partisan bill?
- How far will rates be lowered?
  - What are the pay-fors?
  - Fate of the state and local tax deduction?
  - Revenue neutral or deficit financed?
- Relative effective tax rate for C Corporations and flow-through businesses?
- State Conformity (or non-conformity) to key provisions.
- Revenue windfalls or future state fiscal pressures?