

# How Federal Tax Reform is Changing the State Tax Landscape

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# Objective

Discuss examples of states' reactions to federal tax reform, including:

- Budget and policy considerations
- Communications regarding tax reform
- How the SALT audit landscape is changing regarding:
  - IRC §168(k) –Bonus Depreciation
  - IRC §163(j) Interest Deduction Limitations
  - IRC §965 Deemed Repatriation
  - International Provisions – GILTI / FDII

# Budget and Policy Considerations

- Will there be a windfall?
  - From tax reform
    - See Pennsylvania Independent Fiscal Office Report
  - From *Wayfair*
    - Is sales tax applicable? Existing remote seller rules?
- Application of any windfall
  - State tax reform?
  - Audit resources?
  - Technology?
  - Other?

# Communications Regarding Tax Reform

- Department guidance vs. legislative changes
  - How far can Departments go administratively?
- Timing is essential
  - Tax return preparation – 2017 (ongoing) & 2018
  - Financial statement reporting – quarterly for public companies
- Desk audits and field audits
  - Audit manuals/internal guidance/auditor training
- Technical staff/Q&A requests/ruling requests
- Coordination with taxing systems (technology)

# Tax Reform Comparison

NESTOA States	IRC Conformity Date	IRC. §168(k) Bonus Depreciation - Conformity	IRC. §163(j) Interest Deduction Limitation - Conformity	IRC §965 Repatriation - Conformity	Full or Partial DRD - Repatriation	IRC §965 Repatriation - Guidance Issued	GILTI - IRC §951A - Conformity	IRC §250 Deduction - Conformity	Full or Partial DRD - GILTI	GILTI/FDII - Guidance Issued
Connecticut	Current	No	No	Yes	Partial	Yes (notice)	Yes	Yes	Partial	Yes (notice)
Delaware	Current	Yes	Yes	Yes – 965(a) No – 965(c)	Full	No	Yes	Yes	Full	No
District of Columbia	Current	No	Yes	Yes	Full	No	Yes	Yes	Full	No
Maine	12/31/16	No	No	No	N/A	N/A	No	No	N/A	N/A
Maryland	Current	No	Yes	Yes	Full	No	Yes	Yes	Full	No
Massachusetts	Current	No	Yes	Yes	Partial	Yes (notice)	Yes	Yes	Partial	No
New Hampshire	12/31/15 (TY'17) 12/31/16 (TY'18)	No	No	No	N/A	N/A	No	No	N/A	N/A
New Jersey	Current	No	Yes (pro rata)	Yes – 965(a) No – 965(c)	Partial	Yes (legislation)	Yes	Yes	Partial	No
New York	Current	No	Yes	Yes – 965(a) No – 965(c)	Full	Yes (legislation and notice)	Yes	Yes (GILTI) No (FDII)	Neither	Yes (legislation)
Pennsylvania	Current	No	Yes	Yes	Full	Yes (notice)	Yes	Yes	Full	No
Rhode Island	Current	No	Yes	Yes	Full	Yes (legislation and notice)	Yes	Yes	Full	No
Vermont	12/31/17	No	Yes	Yes	Full	Yes (notice)	Yes	Yes	Full	Yes (publication)

# Questions & Discussion

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# Appendix

State Technical Matters on Federal Tax Reform

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# IRC §168(k) – Bonus Depreciation

- 100% bonus depreciation for property placed in service after Sept. 27, 2017, and before Jan. 1, 2023, with 20% annual phase-down over the following five years
- Used property eligible for bonus depreciation for the first time, but with related party anti-churning rules
- For property acquired before Sept. 27, 2017, and placed in service after that date, the bonus depreciation rate will generally follow the bonus depreciation provisions of the PATH Act
- Special rule allows taxpayers to elect to apply 50% bonus depreciation rather than 100% bonus depreciation for the first taxable year ending after Sept. 27, 2017



## IRC §163(j) – Interest Deduction Limitations

- Limits the deduction for net business interest in excess of interest income to 30% of adjusted taxable income for tax years beginning after Dec. 31, 2017
- Adjusted taxable income is defined as taxable income computed without interest expense, interest income, NOL deductions, and the 20% deduction for certain qualified business income under §199A
- For tax years beginning before Jan. 1, 2022, adjusted taxable income also excludes depreciation, amortization, and depletion (similar to EBITDA) – depreciation, amortization and depletion is included in the calculation thereafter (similar to EBIT)
- Any disallowed interest expense is carried forward indefinitely and existing carryforwards of deferred interest under old Sec. 163(j) rules can be utilized
- Limitation computed at the taxpayer or consolidated group level (not controlled group)

# IRC §163(j) – Interest Deduction Limitations

- Most states are likely to conform to the new IRC §163(j) limitations on interest deductions
- Some states may decouple from the ability to carry forward a disallowed deduction
- The interplay between existing limitations on interest deductions in many separate reporting states, and the new federal limitations must be considered
- To the extent that the federal limitation is calculated on a consolidated basis, there will be issues in determining the calculation in separate states, or in combined states where combined group may be different than the federal consolidated group

# IRC §965 Deemed Repatriation - Scope

- Unrepatriated foreign earnings are subject to a one-time transition tax of 15.5% for cash and cash equivalents and 8% for other assets applicable to U.S. shareholders in “specified foreign corporations”
- Specified foreign corporations are defined to include all CFCs and all other foreign corporations (which are not passive foreign investment corporations) with at least one U.S. corporation as a shareholder
- The one-time tax is imposed by using the Subpart F rules to require applicable U.S. shareholders to include their pro rata share of post-1986 earnings and profits (E&P) in income to the extent such E&P has not been previously subject to U.S. tax

## IRC §965 Deemed Repatriation - Measurement

- E&P includes only earnings that accrued while the foreign corporation was a specified foreign corporation, with a measurement date of either Nov. 2, 2017, or Dec. 31, 2017, whenever the amount was greater
- The inclusion in income is for the foreign subsidiary's last taxable year beginning before 2018, determined without regard to any dividends paid during the taxable year
- An election is available to allow U.S. shareholders to spread the payment of the one-time transition tax liability over eight years
- An election is also available to forgo the use of NOLs to offset the one-time tax inclusion

## IRC §965 Deemed Repatriation – Federal Reporting

- *IRS Questions and Answers about Reporting Related to Section 965 on 2017 Tax Returns* was released on March 13, 2018, with additional guidance added on April 13, 2018
- For C corporations:
  - §965(a) addition and §965(c) subtraction are not reported on Form 1120, Line 4, 26 and/or 29
  - Reported on Transition Tax Statement, with calculated tax included on Form 1120, Schedule J
  - Requires a "With" and "Without" computation to determine the net tax liability under IRC §965(h)
- Query whether this is taxable income for state purposes, or if a state is directly tied to Form 1120, Line 28 or Line 30 as a starting point

# IRC §965 Deemed Repatriation

- Does deemed repatriation amount differs from federal?
  - Post-1986 E&P is aggregated under IRC §965(b)(1)
  - Where state filing groups differ from the federal consolidated group, deemed repatriation may vary.
  - If specified foreign corporations aren't owned by the same U.S. shareholder, there may be no aggregation for separate company states.

# §965 Deemed Repatriation

- How do you source the deemed repatriation?
  - To the extent an inclusion to income remains in the state tax base, is such income classified as business income included in the sales factor, business income excluded from the sales factor, or nonbusiness income?
  - If includable in the sales factor, or if classified as nonbusiness income, how could such income be sourced?
  - Is the federal deferral election ineffective at the state level?
  - Could a state decide to implement its own surtax based on the federal deemed repatriation amount to the extent it does not conform to IRC §965?

# IRC §965 Deemed Repatriation

- Pennsylvania Information Notice 2018-1
  - Repatriation Transition Tax (RTT) under IRC §965 is subject to corporate net income tax, regardless of federal reporting
  - Reported net of RTT Deduction and treated as a dividend under Subpart F
  - Eligible for Pennsylvania DRD
  - As a dividend, excluded from apportionment
  - Not subject to personal income tax until actual distribution out of E&P



# International Provisions – GILTI / FDII

- Global intangible low-taxed income (GILTI) -- effective for tax years beginning after 2017, U.S. shareholders of controlled foreign corporations (CFCs) are subject to current U.S. tax on GILTI, which is defined as the excess of a U.S. shareholder's aggregated net "tested income" from CFCs over a routine return on certain qualified tangible assets over interest expense
  - IRC §951A -- GILTI inclusion amount
  - IRC §250(a)(1)(B) -- GILTI deduction of 50% of GILTI inclusion (37.5% for tax years beginning after 2025) for domestic C corporations, plus IRC §78 deemed dividend attributable to GILTI inclusion
  - GILTI is treated *similarly* to Subpart F income and foreign taxes paid on such income would be available as a credit but would be limited to 80% of taxes otherwise creditable

# International Provisions – GILTI / FDII

- Foreign-derived intangible income (FDII) -- the portion of a domestic corporation's intangible income (determined via formula) derived in connection with property sold by the taxpayer to a foreign person for foreign use, or services provided by the taxpayer provided to a person or with respect to property outside of the U.S.
  - IRC §250(a)(1)(A) -- FDII deduction of 37.5% (21.875% for tax years beginning after 2025) of a domestic C corporation's FDII
  - Complex set of definitional rules, and likely will require new information, processes and analysis