

State corporate tax impacts of federal tax reform

Explanation of the EY Report for the State
Tax Research Institute, prepared in March
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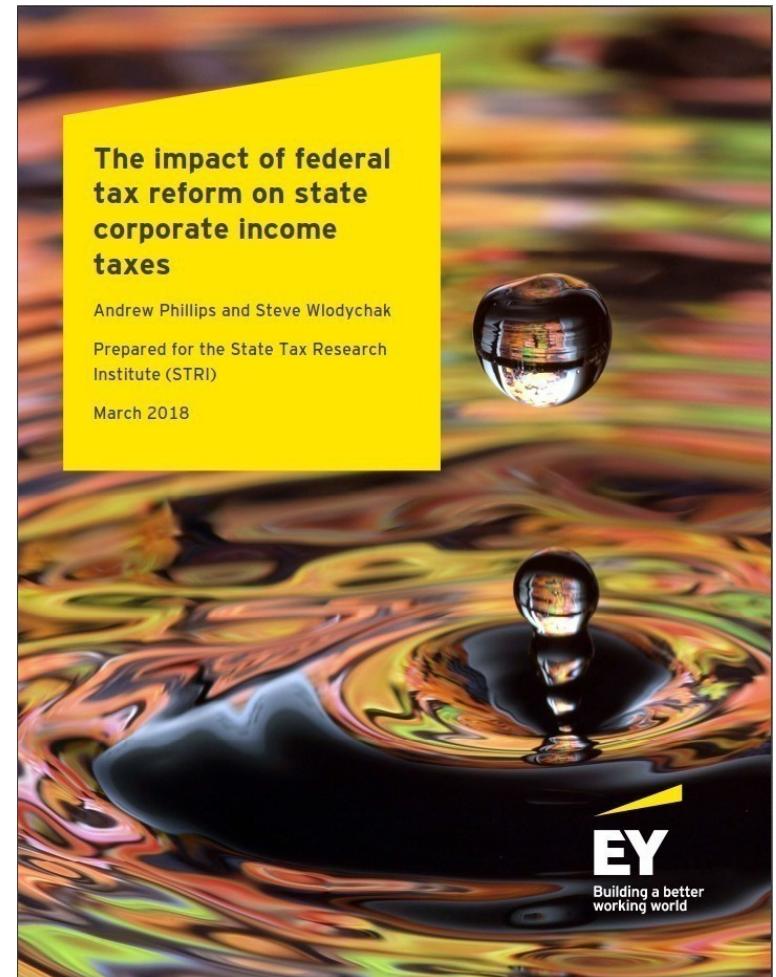
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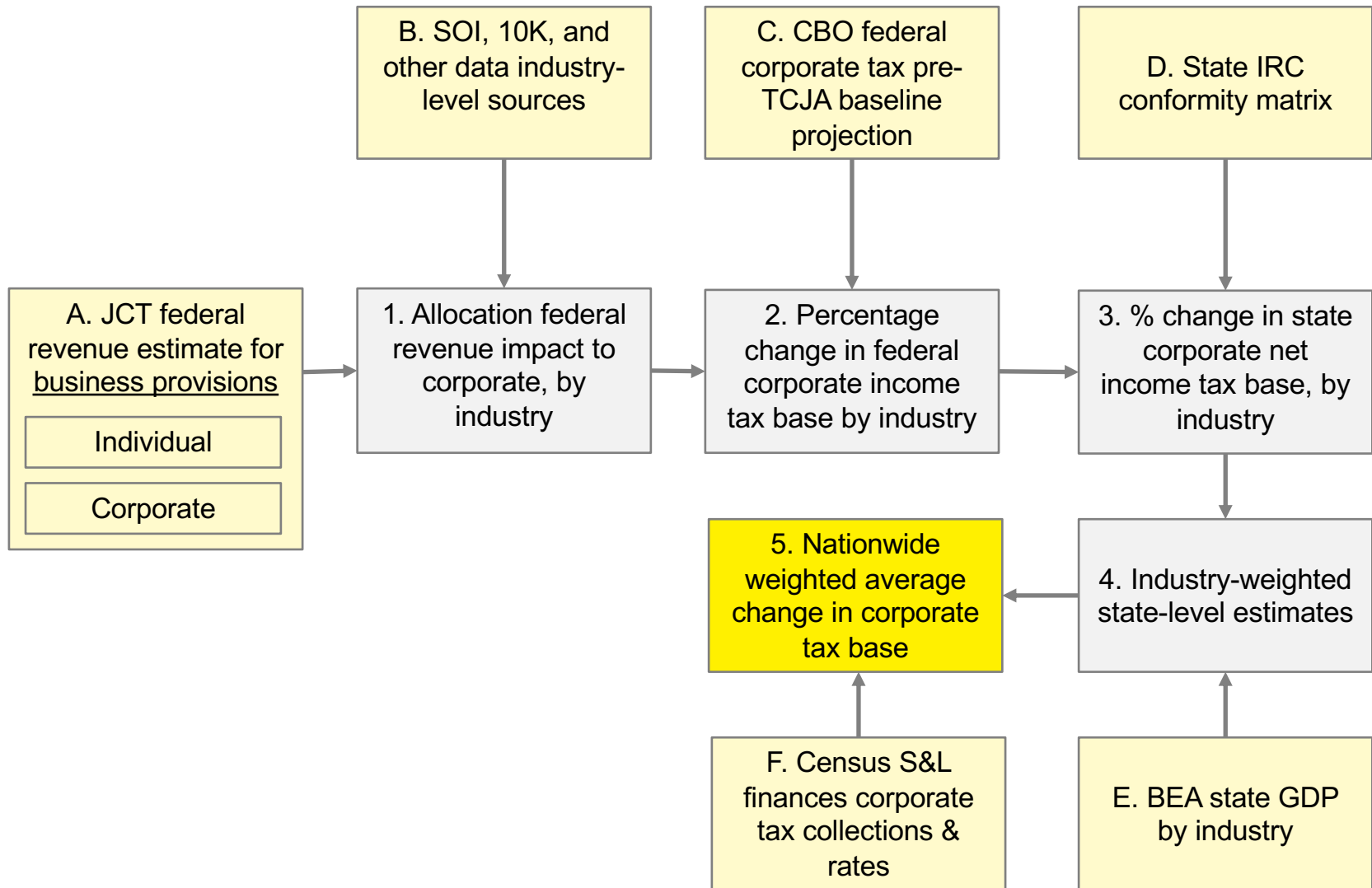
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Quantifying the impacts of TCJA on state corporate taxes

- ▶ March 2018 Ernst & Young LLP/COST study provides estimates of the impacts of TCJA on state corporate tax bases.
- ▶ Study examines the impact of states updating their corporate tax codes to the TCJA, but remaining coupled to specific provisions as they have in the past.
- ▶ Study was conducted prior to conformity legislation in several states.
- ▶ **The estimated percentage change in the state corporate tax base from TCJA is about 12% over the first 10 years (2018-2027), with significant variation among the states.**



Estimation approach



Federal corporate tax base changes for major provisions in TCJA, 2018-2027

Business provision	% change in federal corporate tax base
One-time transition tax on un-repatriated foreign earnings	+9.0%
Net interest expense limitation (30% of adjusted taxable income (ATI))	+6.4%
Modification of net operating loss deduction	+5.3%
Global Intangible Low-Taxed Income (GILTI) inclusion	+5.5%
Deduction for GILTI	(2.6%)
Amortization of research and experimental expenditures	+2.9%
Repeal of domestic production activities deduction (IRC §199)	+1.9%
Limit deduction of fringe benefits	+0.7%
Limit like-kind exchanges of personal property	+0.5%
Base Erosion Anti-Abuse Tax (BEAT)*	0.0%
Increased expensing under IRC §179	(0.3%)
Small business accounting method reform and simplification	(0.8%)
Foreign Derived Intangible Income (FDII) deduction	(1.7%)
Bonus expensing (IRC §168(k))	(1.8%)
Move to territorial system of taxation	(5.9%)
Total change in federal corporate taxable income from major provisions**	+19.1%

Source: Ernst & Young LLP analysis incorporating Joint Committee on Taxation (JCT) revenue estimates

* BEAT is a minimum tax and does not impact the regular tax base

** Total reflects only major provisions shown in this table

Assumed state conformity to business tax reform provisions

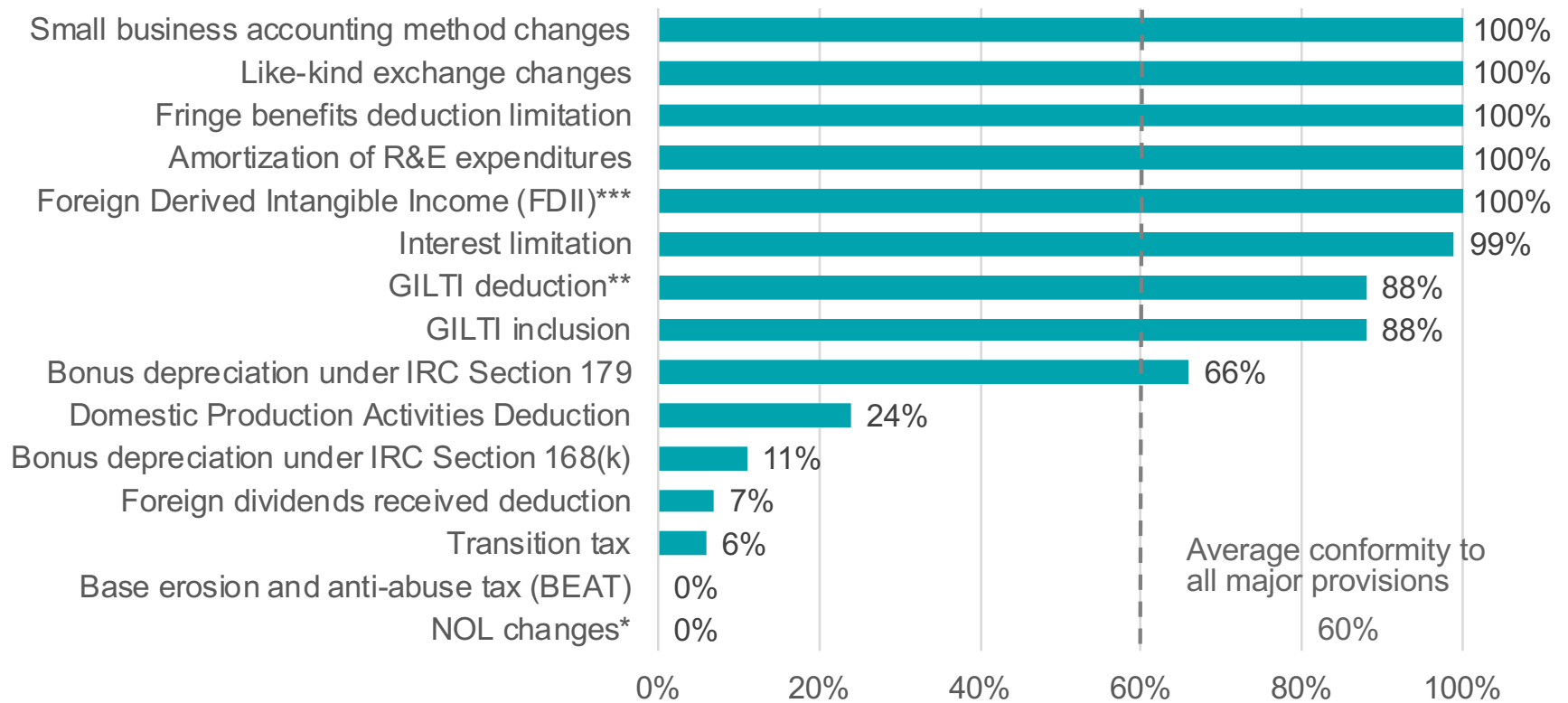
Federal	States
Corporate tax rate reductions	States have own rates
Special 20% Pass-Through Entity (PTE) deduction	Potentially impacts minority of states tied to federal “taxable income” for personal income tax (PIT) purposes
Limitation in deduction of business interest expense that exceeds 30% of adjusted taxable income	State conformity (uncertain application to state filing groups)
Fully expensed investments	2/3 of states opted out of bonus depreciation
Broadened tax base includes repeal of IRC §199 domestic production deduction	State conformity (although many states already opted out of the domestic production deduction)
Limit Net Operating Loss (NOL) deductions	Most states have their own NOL provisions
Amortization of research and experimental expenditures	State conformity

Assumed state conformity to international tax reform provisions

Federal	States
100 percent dividends-received deduction (DRD) for foreign dividends; reduced domestic DRD percentages	Most states have their own DRDs
Transition tax on “deemed” repatriated earnings	One-quarter of states tax some portion of Subpart F income and/or foreign dividends
Tax on GILTI earned by foreign subsidiaries	Likely state conformity (but constitutional limitations)
Deduction of 50% of GILTI income	Partial state conformity (but “special deduction” linkage issues)
Reduced tax on FDII of US corporation	Partial state conformity (but “special deduction” linkage issues)
BEAT	Separate tax base not in federal taxable income; states don’t conform
Longer amortization schedule for foreign research and experimentation (15 years)	Likely state conformity (but constitutional issues)

What share of major federal corporate tax provisions impact the states?

Assumed share of federal corporate tax base change impacting state corporate tax bases, assuming updated conformity to 1/1/18 IRC, 2018-2027



* While there would likely be some impact from federal NOL changes, no impact is assumed in the analysis

** Deduction is assumed not to be available in states that exclude the related income from the tax base

*** Considerable uncertainty about state conformity to IRC Section 250 GILTI and FDII deductions exists

Estimated percentage change in state corporate tax base from TCJA by state (2018-2027)

State	% increase in state corporate tax base	State	% increase in state corporate tax base
Alabama	11%	Nebraska	11%
Alaska*	12%	Nevada	n/a
Arizona	14%	New Hampshire*	13%
Arkansas	12%	New Jersey*	12%
California**	12%	New Mexico*	11%
Colorado	12%	New York*	12%
Connecticut*	12%	North Carolina	12%
Delaware	10%	North Dakota	10%
Florida	13%	Ohio	n/a
Georgia	12%	Oklahoma	13%
Hawaii*	13%	Oregon*	10%
Idaho	9%	Pennsylvania*	14%
Illinois	9%	Rhode Island*	11%
Indiana*	12%	South Carolina	12%
Iowa	13%	South Dakota	n/a
Kansas	11%	Tennessee*	12%
Kentucky*	12%	Texas	n/a
Louisiana	12%	Utah*	12%
Maine	12%	Vermont	14%
Maryland*	12%	Virginia	13%
Massachusetts*	12%	Washington	n/a
Michigan	9%	West Virginia	9%
Minnesota*	12%	Wisconsin*	9%
Mississippi*	4%	Wyoming	n/a
Missouri	11%	District of Columbia	12%
Montana*	9%	Overall change	12%

* State starts with IRS Form 1120 line 28. To the extent IRC § 250 deductions not allowed, this impact would be higher by 4%.

** There may be a California impact relating to cash repatriation for waters'-edge filers once the deemed repatriated earnings have been actually distributed as dividends to US corporate shareholders. California Franchise Tax Board has estimated this amount at approximately \$350 million.

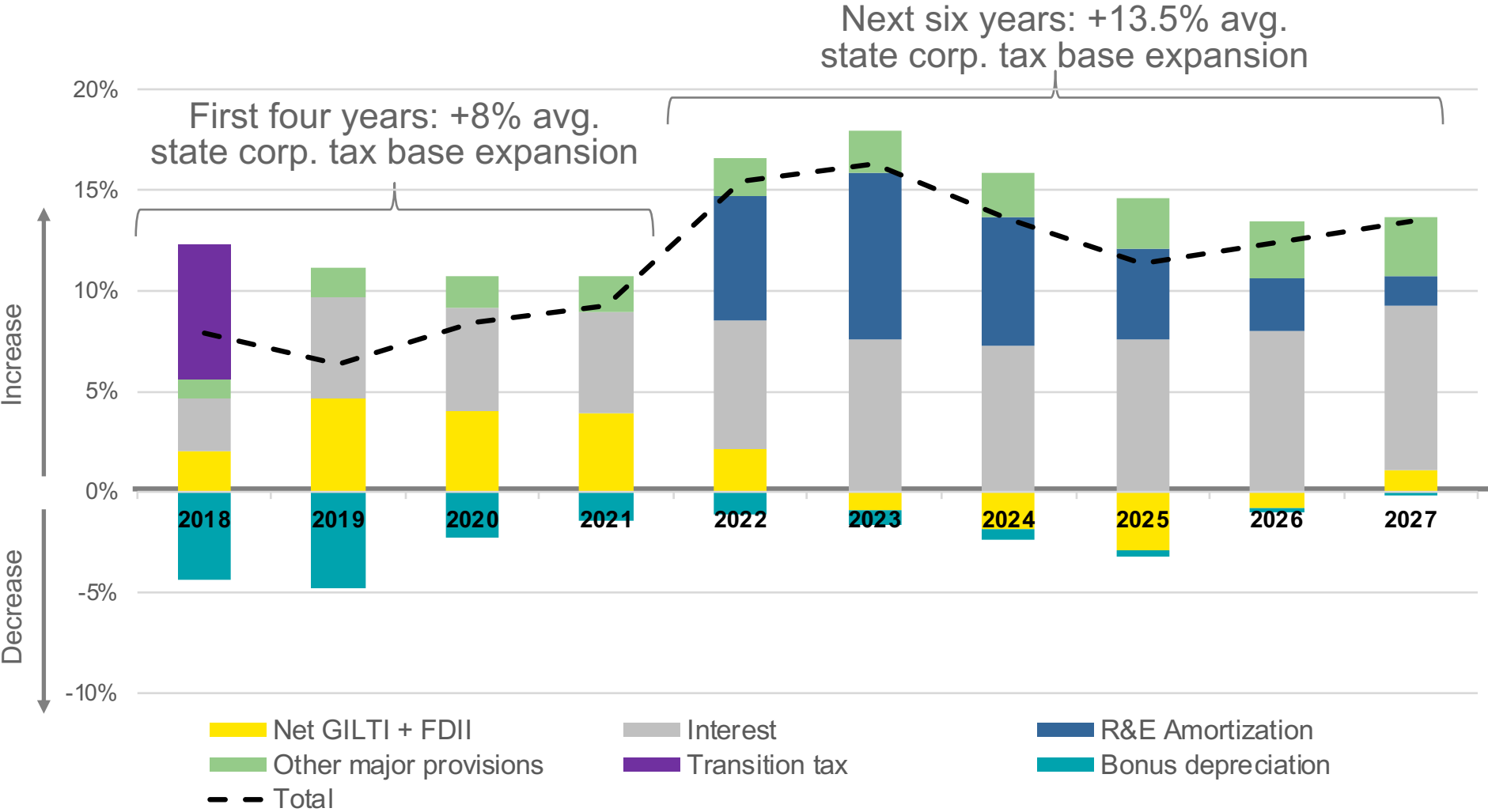
Which industries are impacted?

Estimated expansion in state corporate income tax base by industry sector (% change in federal and state corporate tax base from major IRC provisions, 2018-2027)

Industry sectors (C corporations only)	Estimated <u>federal</u> corporate tax base expansion	Estimated <u>state</u> corporate tax base expansion
Manufacturing sector	23%	12%
Capital intensive services sector (transport, information, utility, real estate)	29%	17%
Labor intensive services sector (trade, professional and personal services)	10%	9%
Finance and holding company sector	18%	8%
Other industries sector (agriculture, mining, construction)	23%	13%
Overall change for all industries from major provisions	19%	12%

What's driving the state corporate tax base change over the next decade?

Time trend of state corporate tax base expansion, by year

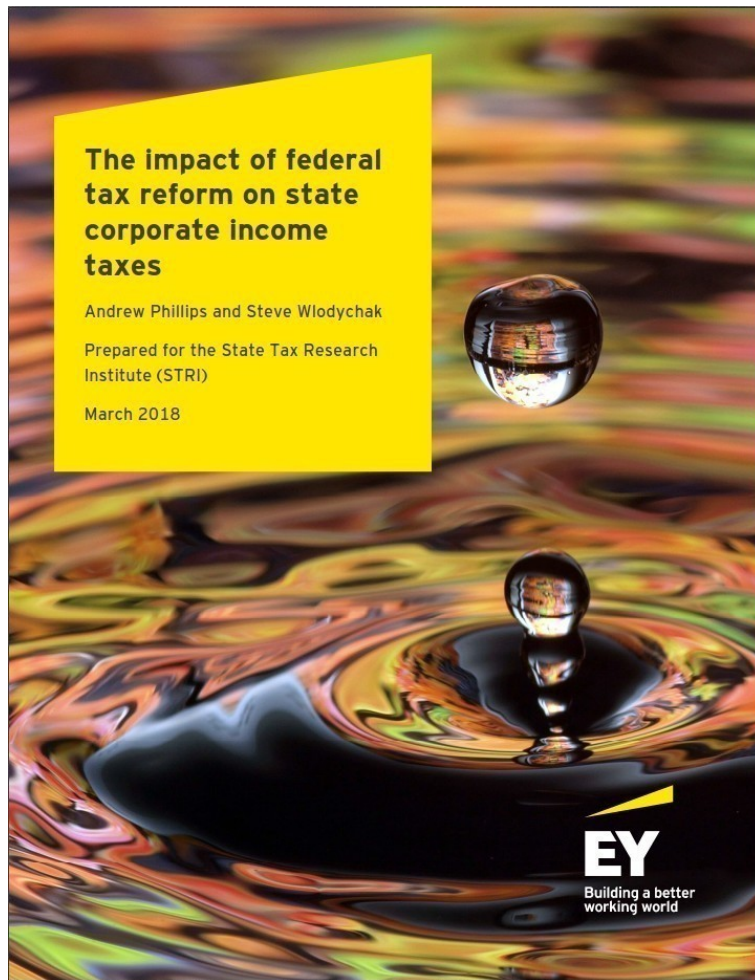


State responses to TCJA

(As of June 26, 2018)

TCJA provision / State proposal	State actions
IRC conformity update bills	Enacted: AZ, FL, GA, HI, ID, IN, IA, KY, MI, NC, OR, VA, WV, WI Proposed: MN (vetoed), VT (vetoed)
IRC §965 (transition tax on accumulated foreign earnings)	Enacted: ID, IN, GA, NY, NC, OR, UT, WI Proposed: ME, MD, MA, MN (vetoed), NJ Guidance: AL, AZ, CA, CO, CT, FL, IL, MA, NJ, NY, OR, PA, RI, TN
IRC §245A (future foreign DRD), §250 (FDII/GILTI deduction), §951A (GILTI)	Enacted: GA, HI, ID, IN, NY, NC, WI Proposed: IL, MA, MN (vetoed), NY
30% business interest expense limitation (IRC §163(j))	Enacted: CT, GA, IN, TN, WI Proposed: NJ, NY
PTE deduction (IRC §199A)	Enacted: CT, HI, IN, KY, OR, WI - decouple; IA (allow) Proposed: ME, MT (proposed reg.), NJ, NM
Bonus depreciation (IRC §168(k))	Enacted: CT, FL, IA, KY, OH, WI – all decouple Proposed: ME, NY, PA (couple)(approved by legislature), TN (couple)
SALT cap workaround/charitable contribution in lieu of tax	Enacted: CT, NY, NJ, OR Proposed: CA, DC, ID, MD, RI, WA
Carried interest fee	Proposed: CA, IL, NJ, NY, RI
Employer payroll tax	Enacted: NY
New entity level tax on PTEs	Enacted: CT Proposed: CA, NY

Where can I find a copy of the study?



The study is available on-line at:
[http://www.ey.com/Publication/vwLUAssets/ey-the-impact-of-federal-tax-reform-on-state-corporate-income-taxes/\\$File/ey-the-impact-of-federal-tax-reform-on-state-corporate-income-taxes.pdf](http://www.ey.com/Publication/vwLUAssets/ey-the-impact-of-federal-tax-reform-on-state-corporate-income-taxes/$File/ey-the-impact-of-federal-tax-reform-on-state-corporate-income-taxes.pdf)

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