



# Federal Tax Reform Proposals: State Tax Implications

FTA Revenue Estimating Conference  
Kansas City, Missouri

October 18, 2021



# Agenda

## Where are we?

## What's been proposed?

- Treasury Green Book
- Ways and Means bill

## House Ways and Means bill

- Revenue reducing measures
- Revenue increasing measures
- Closer look at the corporate/international provisions
- Key implications for states

## What's next?

## Resources



What's been proposed?

# Biden Administration Green Book

**President American Jobs Plan outlined in Treasury Green Book in late May**

**Proposed net revenue increases of about \$2.9 trillion over 10 years**

**Revenue increasing measures focused on:**

- Increasing corporate rate to 28 percent (\$858 Billion)
- Modify GILTI, FDII and convert BEAT to SHIELD (\$950 Billion+)
- Financial account reporting (\$460 Billion)
- Increasing individual top rate to 39 percent (\$132 Billion)
- Increasing taxation of capital gains at individual level (\$320 Billion)

**Revenue reducing measures included:**

- Extend and modify Child Tax Credit (-\$450 Billion)
- Renewable and alternative energy incentives (-\$265 Billion)
- Extend ARPA Earned Income Credit provisions (-\$163 Billion)
- Extend ARPA Child and Dependent Care Credit provisions (-\$104 Billion)

# Ways and Means proposal

**In September 2021, House Ways and Means Committee reported its Build Back Better plan as part of budget reconciliation process**

**Ways and Means tax provisions generate about \$870 billion in net revenues over a 10-year window**

- Compared to \$2.9 trillion in Green Book
- Partially due to assumption of increased deficit in budget resolution
- Areas of focus generally the same as Green Book, but some scaling back
- Particularly on the revenue increase side due to reconciliation instructions

# Revenue reducing measures

<b>Infrastructure Financing and Community Development</b>	<b>-\$131.5 B</b>
Various bond financing arrangements	(\$42.0 B)
Rehabilitation tax credit	(\$26.5 B)
Housing (LIHTC, bonds and other credits)	(\$47.0 B)
<b>Growing Renewable Energy and Efficiency Now (GREEN)</b>	<b>-\$235.0 B</b>
Renewable electricity and carbon sequestration (PTC, others)	(\$134.3 B)
Renewable fuels	(\$42.8 B)
Green energy and efficiency incentives for individuals	(\$39.3 B)
Greening the fleet and alternative vehicles	(\$42.4 B)
Reinstate Superfund Taxes	\$38.4 B
<b>Social Safety Net</b>	<b>-\$835.0 B</b>
Child tax credit (thru 2025)	(\$556.0 B)
Child and dependent care tax credit	(\$98.4 B)
Earned income tax credit	(\$135.4 B)

# Revenue increasing measures

<b>Corporate and international tax reforms</b>		<b>\$963.6B</b>
Increase rate to 26.5 percent		\$540.1 B
Increased limitations on interest deductibility (IRC 163(n))		\$34.8 B
Modifications to GILTI and FDII		\$163.3 B
Country by country computation of FTC		\$63.3 B
Modifications to BEAT		\$24.9 B
<b>High-income individual taxpayers</b>		<b>\$1.0 T</b>
Increase top marginal rate to 39.6 percent		\$170.5 B
Increase rate and lower bracket for long-term gains and dividends		\$123.4 B
Apply NIIT to income from trade or business		\$252.2 B
Limit Sec. 199A deduction for some taxpayers (4 years)		\$78.0 B
Surcharge on high income individuals (3%, \$5 million)		\$127.3 B
Continue limitation on use of excess business losses (begin 2027)		\$166.8 B

# Ways and Means “Build Back Better” Plan

Provision	House Ways and Means
<b>GILTI</b>	<ul style="list-style-type: none"> <li>— Increase effective rate of U.S. tax on GILTI to 16.5625% by increasing the U.S. corporate rate to 26.5% and decreasing the section 250 deduction to 37.5%</li> <li>— Compute GILTI on a country-by-country basis (details are limited)</li> <li>— Reduce QBAI deduction from 10% to 5% of a CFC’s tangible assets</li> <li>— Reduce 20 percent ‘haircut’ on deemed credit for tax paid to 5 percent</li> </ul>
<b>FDII</b>	<ul style="list-style-type: none"> <li>— Retain FDII deduction but reduce to 21.875%</li> <li>— Allow the section 250 deduction for GILTI and FDII to create a NOL</li> </ul>
<b>BEAT</b>	<ul style="list-style-type: none"> <li>— Modifies BEAT provisions, including raising the rate and revising the rules for determining modified taxable income</li> </ul>
<b>Section 163(j)</b>	<ul style="list-style-type: none"> <li>— Retains 163(j), but no more indefinite carryforwards</li> </ul>
<b>Limitation of Interest Expense under 163(n)</b>	<ul style="list-style-type: none"> <li>— General rule: the interest expense deduction of a “specified domestic corporation” that is a member of an international financial reporting group cannot exceed the “allowable percentage” of 110% of the corporation’s net interest expense</li> <li>— A corporation that was subject to both section 163(j) and 163(n) would apply whichever of the two provisions imposed the lower limitation</li> <li>— The carryover period for all disallowed interest would be limited to five tax years</li> </ul>
<b>Corporate Tax Rate</b>	<ul style="list-style-type: none"> <li>— Increase from 21% to 26.5%</li> </ul>



# Proposed GILTI law changes

## — Changes to GILTI regime

- Changes to GILTI would likely result in significant compliance and reporting challenges.
  - Rolling: These states would likely automatically adopt the relevant changes.
  - Fixed-Date: These states would likely not automatically adopt the changes.
  - Selective Conformity: These states would likely not automatically adopt the changes.
- State impact will also depend on state-specific decoupling provisions and conformity to the underlying federal provisions.

## — State considerations

- How would the GILTI computation in a particular state differ from the federal computation as a result of a reduction or elimination of QBAI?
- How would a reduction in the Section 250 deduction impact state income taxes?
- In the states that a adopt a specific fixed percentage deduction for GILTI (e.g., 50 percent), a legislative change would be needed to reduce the state's fixed deduction

# Proposed FDII reduction/ BEAT modifications

## House Ways and Means Committee Proposals

### FDII

- More than 20 states currently allow the FDII deduction
- The proposed legislation would reduce the FDII deduction to 21.875% deduction (previously 37.5%)
- Under the proposed legislation, if the section 250 deduction with respect to GILTI or FDII exceeds taxable income, the excess is allowed as a deduction, which will increase the net operating loss for the taxable year
- Application at the state level will likely depend on whether the state conforms to the proposed change, adopts GILTI and/or FDII and the extent to which the state adopts or incorporates the federal NOL
- In certain states, a GILTI or FDII deduction that creates a net operating loss under the proposed amendment may not create a state net operating loss

### BEAT

- Would continue to be treated as a separate minimum tax, but the rate would increase and the rules around determining modified taxable income would change
- No direct state impact (except for Alaska)
- May have an indirect impact on state taxable income
  - The increased BEAT rate and expansion of payments potentially subject to the BEAT may cause taxpayers to consider waiving more deductions to avoid becoming subject to the BEAT

# Proposed corporate tax rate increase

- Proposed corporate tax rate increase to 26.5% from 21%
- No direct impact on states as states establish their own rates, although some states allow a deduction for federal income taxes, so may increase that deduction
- State considerations related to federal planning associated with the proposed corporate tax rate change

# Key implications for states

## Overall impacts

- Limited direct impacts because of modest tax base (individual or corporate changes)
- Degree of any impact is dependent on degree of and nature of conformity to the IRC

## Individual provisions

- To what degree does state conform to Child Tax Credit, Earned Income Credit and Child and Dependent Care Credit
- What is nature of conformity - allowable expenses, level of expenses or rate/amount of credit
- Worth watching taxation of gains discussion; some discussion of the tax on gains at death
- Any effects on mobility?

## Corporate changes

- To what extent and in what manner does state conform to GILTI and FDII – base, Sec. 250 deduction
- Timing of conformity changes
- Monitor BEAT v. SHIELD discussion
- Possible secondary effects
  - Possible responses to federal rate changes
  - Possible moves to avoid BEAT by deferring deductions

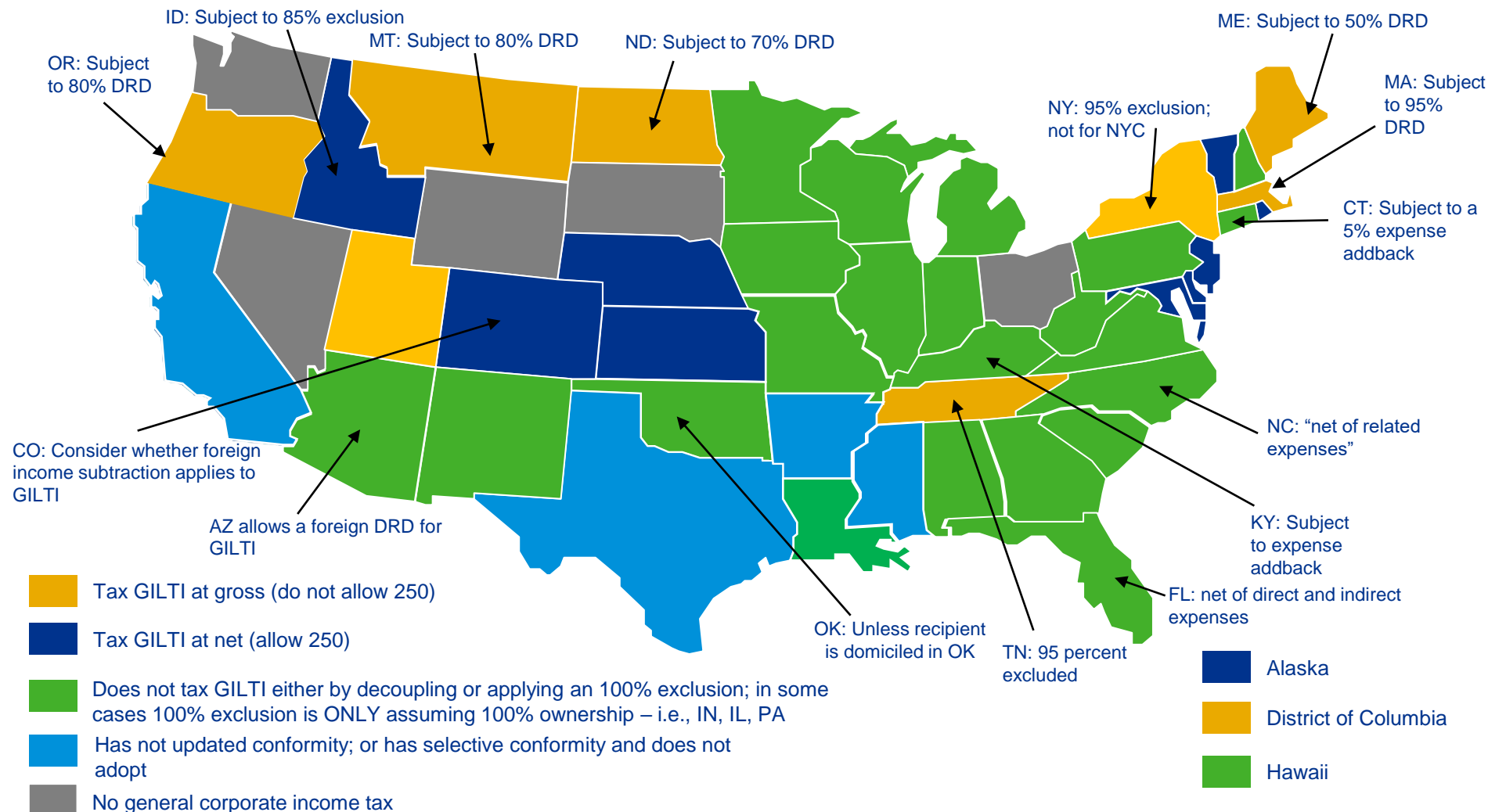


What's next?

# Lessons learned from TCJA

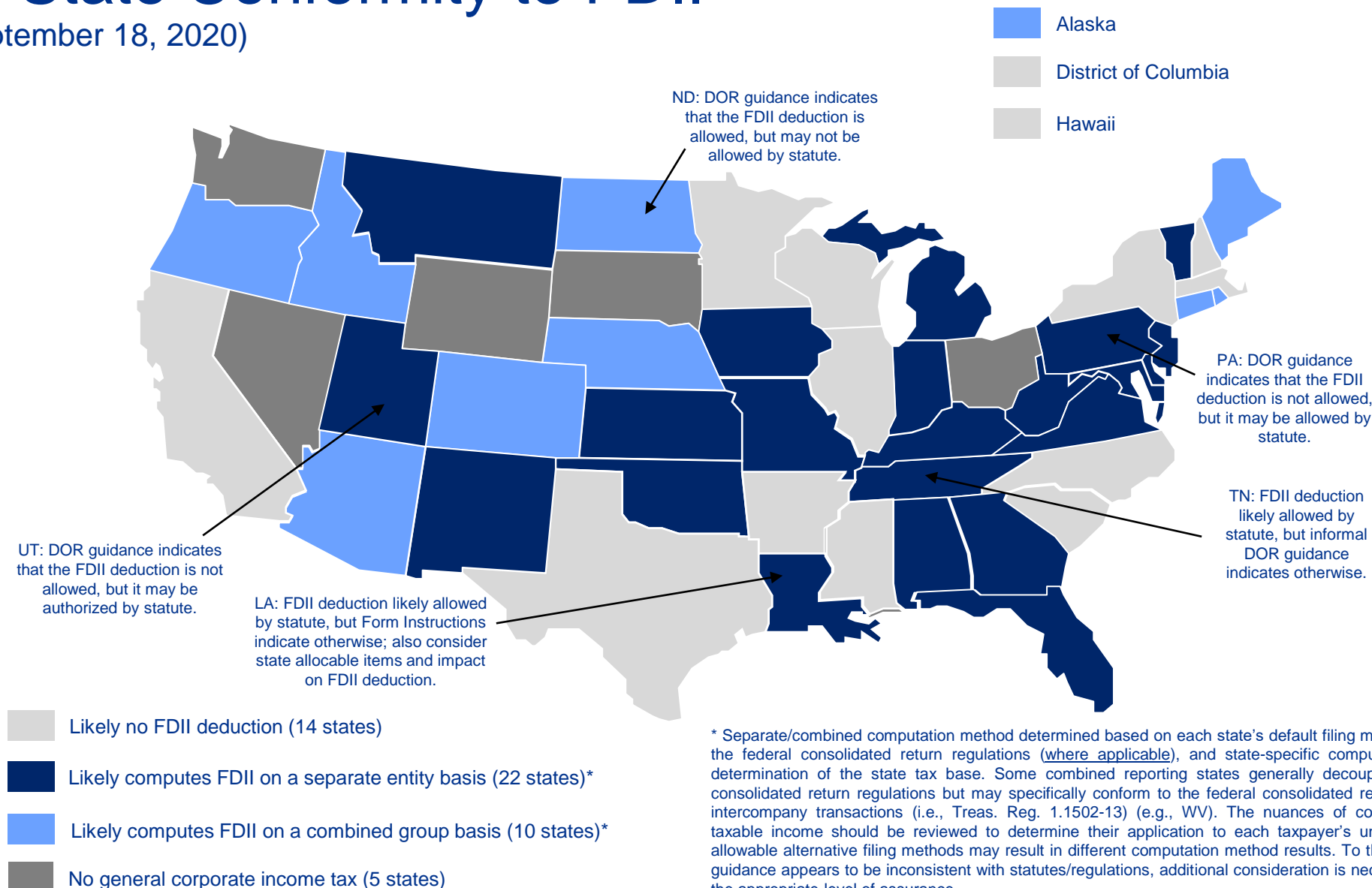
- It may take a few years for states to formulate policies and enact laws addressing the federal changes
  - Some states are still in the process of adjusting to TCJA!
  - About half the states require legislative action to adopt federal law changes and some state legislatures don't meet each year without a special session
- Even for states that automatically adopt federal changes, we could see delays in guidance on the application of the changes for the state(s), including form revisions, etc.
- State conformity / non-conformity is dependent on a number of state-specific factors
  - How the state(s) generally conforms to the IRC
  - The political makeup of the state legislature and executive branch (as well as pending state elections)
  - Each state's current and projected fiscal condition
  - The current treatment of any of the IRC sections that are impacted by reform
- Here we go again!
- A request/plea?
  - More guidance is better than less guidance
  - At some point, conformity can become a virtue in and of itself

# State taxation of GILTI in 2020



# 2019 State Conformity to FDII

(as of September 18, 2020)



\* Separate/combined computation method determined based on each state's default filing method, application of the federal consolidated return regulations (where applicable), and state-specific computation rules for the determination of the state tax base. Some combined reporting states generally decouple from the federal consolidated return regulations but may specifically conform to the federal consolidated return rules related to intercompany transactions (i.e., Treas. Reg. 1.1502-13) (e.g., WV). The nuances of combined group state taxable income should be reviewed to determine their application to each taxpayer's unique facts. Further, allowable alternative filing methods may result in different computation method results. To the extent state DOR guidance appears to be inconsistent with statutes/regulations, additional consideration is necessary to determine the appropriate level of assurance.





# Additional resources

# Available resources

[TaxNewsFlash-Biden Tax Agenda - KPMG United States \(home.kpmg\)](#)

[KPMG report: Tax proposals in FY 2022 budget - KPMG United States \(home.kpmg\)](#)

[KPMG report: Tax proposals for budget reconciliation - KPMG United States \(home.kpmg\)](#)

# Contact information

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# Biden “American Jobs Plan”

Provision	Biden “American Jobs Plan”
<b>GILTI</b>	<ul style="list-style-type: none"> <li>— Increase effective rate of U.S. tax on GILTI to 21% by increasing the U.S. corporate rate to 28% and decreasing the section 250 deduction to 25% maximum</li> <li>— Compute GILTI on a country-by-country basis (details are limited)</li> <li>— Eliminate QBAI</li> </ul>
<b>FDII</b>	<ul style="list-style-type: none"> <li>— Repeal and replace with more direct R&amp;D incentives (details not provided)</li> <li>— Refers to FDII as an “export preference”</li> </ul>
<b>SHIELD</b>	<ul style="list-style-type: none"> <li>— BEAT to be replaced with SHIELD (Stopping Harmful Inversions and Ending Low-tax Developments), which would deny deductions on payments to low-taxed related parties when the related party is not subject to an acceptable global minimum tax; set rate at the GILTI rate pending a multilateral agreement on a min tax rate</li> </ul>
<b>Section 265</b>	<ul style="list-style-type: none"> <li>— Disallow deductions allocated to partially exempt or fully exempt income (e.g., dividends deducted under section 245A, and section 250 deductions related to GILTI)</li> </ul>
<b>Limitation of Interest Expense</b>	<ul style="list-style-type: none"> <li>— General rule: Taxpayer’s net interest expense generally limited to proportionate share of its financial reporting group’s (FRG’s) total financial statement net interest expense, with such share based on the taxpayer’s share of the FRG’s financial statement EBITDA</li> <li>— Alternative elective method: Net interest expense limitation equal to 10% of ATI (as defined in section 163(j))</li> </ul>
<b>Corporate Tax Rate</b>	<ul style="list-style-type: none"> <li>— Increase from 21% to 28%</li> </ul>