Published on *The National Law Review* https://natlawreview.com

More States Respond to Federal Tax Reform

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It's been nearly three months since the federal tax reform bill (commonly referred to as the Tax Cuts and Jobs Act, or "TCJA") was enacted and states continue to respond to the various provisions of the TCJA. Recently, there have been notable legislative efforts in New York, Idaho, Iowa and Minnesota.

New York

Starting with the release of the Governor's Budget Bill in January 2018, the 30-day amendments to that Bill on February 15, and the amendments to the Assembly Bill and Senate Bill this month, there has been much action this legislative session concerning the potential response to federal tax reform. The proposed response in the two latest bills—the Assembly Bill (AB 9509) and the Senate Bill (SB 7509)—is discussed below.

Repatriated Earnings: Both the Assembly and the Senate Bills contain the changes originally suggested in the 30-day amendments to the Governor's Budget Bill with respect to the deemed repatriated earnings under IRC § 965. This language provides that the deemed repatriated earnings will be considered "exempt CFC income" with the result that *any amount included in the federal tax base under the repatriation transition provisions will be excluded from the taxable income base, even if such amounts were received from a non-unitary subsidiary.* This proposed exclusion for amounts deemed received from non-unitary subsidiaries is an expansion of New York's usual policy, which only considered exempt CFC income to include income from unitary subsidiaries.

Both Bills also make clear that the federal deduction permitted under IRC § 965(c) (which facilitates a reduction of the effective federal tax rate on the deemed repatriated foreign earnings) would not be allowed in computing New York taxable income. We expected New York would make this proposed change because disallowing the § 965(c) deduction from New York taxable income would be consistent with excluding the deemed repatriation from taxable income.

GILTI: The Senate Bill now attempts to extend similar treatment to global intangible low-taxed income (GILTI) that may be included in a taxpayer's income under IRC § 951A, with the result that GILTI would be "exempt CFC income" excluded from taxable income. As with the deemed repatriated earnings, this treatment would extend to GILTI attributable to non-unitary subsidiaries.

Technical adjustments may need to be made to the language in the Senate Bill to implement the treatment intended by the Senate because the current language provides for an exclusion for “income required to be included in the taxpayer’s federal gross income *pursuant to subsection (A) of Section 951 of the Internal Revenue Code*, without regard to the deduction under Section 250 of the Internal Revenue Code . . . ” The proper reference, however, should be to IRC § 951A, not IRC § 951(A).

In addition, as with the deduction that is intended to provide a reduced federal rate on the deemed repatriated foreign earnings, the Senate Bill also provides that the GILTI deduction would not be excluded in determining taxpayers’ income tax bases.

Interest Limitation. The Senate Bill also provides that New York State would decouple from the interest limitations under IRC § 163(j). However, it is not certain that the language used in the Senate Bill will be effective in completely decoupling from IRC § 163(j). The language provides that a taxpayer’s entire net income for New York State purposes will be computed “without the exclusion, deduction or credit of . . . the amount disallowed as a deduction pursuant to” IRC § 163(j)(1). However, IRC § 163(j)(1) does not exclude, deduct or credit the interest disallowance in computing federal taxable income; IRC 163(j)(1) includes such amount. Therefore, the statutory language should be enacted, consistent with other statutory add-back modifications in New York’s Tax Law, to provide that entire net income shall not “include” the IRC §163(j)(1) disallowance.

FDII: Under the Senate Bill, the Foreign-Derived Intangible Income (FDII) deduction allowed by IRC § 250 would be allowed in computing the income tax base of the New York corporate franchise tax.

FDIC Premiums: The Senate Bill provides that New York State would decouple from the provision disallowing the deduction of Federal Deposit Insurance Corporation (FDIC) premiums.

Surcharge: The Assembly Bill, but not the Senate Bill, also includes the imposition of a 3 percent tax surcharge on the franchise tax liability of most corporations. This is designed to tax the “windfall” that corporations have been touted to have received under the TCJA.

New York City Conformity: The Assembly Bill and the Senate Bill both extend their proposed statutory adjustments in response to the TCJA to the New York City Administrative Code, thus retaining conformity between the New York State and the New York City corporate franchise taxes.

Idaho

On February 9, 2018, Idaho Governor Otter signed into law HB 355. Under this legislation, the Idaho Code adopted the deemed repatriated foreign earnings provisions in IRC § 965. Because the starting point for computing the Idaho state tax base is federal taxable income, under this Idaho legislation the foreign earnings deemed repatriated under IRC § 965 should be included in the Idaho state tax base for tax years beginning on or after January 1, 2017. However, the legislation explicitly disallows the deduction under IRC § 965(c) which is used to facilitate the reduced federal tax rate on the deemed repatriated foreign earnings. Accordingly, since Idaho does not seem to have a modification that would exclude the deemed repatriated foreign earnings from the state tax base, Idaho taxpayers appear to be required to include the *full* amount of the deemed repatriated foreign earnings under IRC § 965(a) in the Idaho state tax base.

On March 12, 2018, the Governor signed into law HB 463. This legislation provides that for tax years beginning on or after January 1, 2018, Idaho conforms to the IRC as in effect on January 1, 2018, including the provisions of the TCJA. Thus, GILTI included in federal taxable income under IRC § 951A should be included in the Idaho state tax base beginning in 2018. However, as with the disallowance of the deduction for deemed repatriated foreign earnings under HB 355, HB 463 explicitly disallows the IRC § 250 deduction for 50 percent of the GILTI, which at the federal level facilitates the reduced effective tax rate on the GILTI. Thus, under the legislation the *full* amount of the GILTI should be included in the Idaho state tax base. This legislation also disallows the deduction for IRC § 78 gross-up amounts related to GILTI and the federal deduction for 37.5 percent of FDII, both provided for in IRC § 250.

There is proposed legislation in Idaho that would change one of the recently enacted provisions by removing the state's addback of deductions under IRC § 965(c) (but not IRC § 250). HB 684. This bill was heard and passed out of the House Revenue and Taxation Committee earlier this week.

Iowa

Iowa SF 2383 would provide rolling conformity with the IRC beginning on January 1, 2019. The bill would also change Iowa's net operating loss regime for tax years beginning on or after January 1, 2019, to specifically conform to the federal regime. Currently, the starting point for computing the Iowa tax base is federal taxable income before the federal net operating loss deduction and then Iowa provides a net operating loss deduction to the extent apportioned Iowa taxable income results in a net operating loss. The bill would change the starting point for determining the corporate state tax base to federal taxable income including the federal net operating loss deduction and remove the Iowa net operating loss deduction. To address carryforwards, the bill would provide that federal net operating losses carried forward from a year beginning before January 1, 2019, should be added back to the state tax base and, instead, the Iowa net operating loss deduction as computed under the current law would be permitted with respect to loss carryforwards from a year beginning before January 1, 2019.

The bill does not specifically address Iowa's treatment of any of the TCJA provisions. Since the rolling IRC conformity would apply to tax years beginning on or after January 1, 2019, the foreign earnings deemed repatriated under IRC § 965 would not impact the computation of a taxpayer's Iowa corporate income tax. With respect to the GILTI included in the federal tax base under IRC § 951A, that income would be included in the Iowa state tax base under the bill, along with the 50 percent deduction of such income provided in IRC § 250. Iowa does provide a deduction for "the amount of foreign dividend income, including subpart F income as defined in section 952 of the Internal Revenue Code, based upon the percentage of ownership as set forth in section 243 of the Internal Revenue Code" (Iowa Code § 422.35.21); however, that deduction would only apply to the extent that GILTI is considered a dividend because GILTI is not subpart F income as defined in section 952. While uncertain, it is unlikely that GILTI will be considered a dividend. Assuming the GILTI is not a dividend, GILTI, net of the 50 percent deduction in IRC § 250, would be included in the Iowa state tax base under the bill. The deduction for the Section 78 GILTI gross-up and the deduction related to FDII would also be allowed under the Iowa bill.

The bill would also decouple from federal expensing provisions in IRC § 168(k), as amended by the TCJA for tax years beginning on or after January 1, 2019.

Minnesota

Minnesota HF 3656 would provide conformity to the IRC as of December 23, 2017, but not for corporate filers (for which conformity with the IRC remains December 16, 2016). Thus, the bill would not adopt the provisions of the TCJA for corporate filers.

This bill was introduced in the House of Representatives on March 12, 2018.

National Law Review, Volume VIII, Number 78