

State Responses to TCJA's International Provisions

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Pre-TCJA Federal and State Taxation of Worldwide Income

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Pre-TCJA Federal Treatment - Generally

- **U.S. Entities – taxed on worldwide income but income of foreign subsidiaries is not taxed until repatriated (typically through the payment of a dividend)**
 - Special deductions
 - Subpart F income
 - Credit for foreign taxes paid
- **Foreign Entities – taxed on U.S. source income determined under federal rules**
 - Credit for foreign taxes paid

Pre-TCJA State Treatment – Generally

- **States use formulary apportionment to source income**
- **Most states now require “combined” filing**
- **At one time, states sought to use worldwide combined filing and apportionment to source domestic and foreign income**
 - U.S. trading partners urged the Reagan administration to have limits imposed on the states’ ability to do worldwide combined filing
 - States agreed to follow federal treatment of U.S. versus foreign source income – provided that the federal government committed to policing off-shore income shifting
- **Combined filing states, therefore, apply some sort of “water’s edge” limitation on the combined group—but may include foreign dividends and subpart F income.**

Other State Considerations

- **The Foreign Commerce Clause of the U.S. Constitution and the dormant version of that clause**
 - Generally:
 - Sufficient connection
 - No discrimination
 - Fair apportionment
 - No significant risk of multiple taxation
 - No interference with the ability of the federal government to “speak with one voice”
 - ***Kraft Gen. Foods v. Iowa Dep’t of Revenue***

Federal Purpose in International Changes

- **Repatriation –**
 - The purpose is to shift from worldwide taxation of the income of domestic entities to more of a territorial style system.
 - Overseas earnings and profits that have not been repatriated would otherwise escape tax under this system.
- **Global Intangible Low Taxed Income (GILTI) –**
 - Attributes some portion of the income of foreign subsidiaries that would be foreign-sourced to the domestic parent and treats that income as U.S. income.
 - Taxes at a reduced rate and subject to a credit for foreign taxes paid.

Section 965 Repatriation

Repatriation Transition Tax: Determining the State and Local Impact

Overview of Issues

Impact of date of IRC conformity

Assuming the state conforms to the IRC post TCJA, is income included in federal income under IRC 965 included in the state tax base?

- Deemed repatriated foreign earnings are included in income under the Subpart F provisions, IRC 951(a), but are not technically defined as "Subpart F" income under IRC section 952
- Under this structure, such foreign earnings may not necessarily be excluded in states that do not tax subpart F income
- State tax policy reasons for inclusion/exclusion of 965 income

Repatriation Transition Tax: Determining the State and Local Impact

Overview of Issues (cont.)

Application of the IRC § 965(c) deduction (intended to lower the federal tax rate).

- IRC § 965(c) deduction is not a “special deduction” so should be allowed in most states that tax foreign earnings deemed retreated under IRC 965
- Interplay with applicable dividend-received deductions

Apportionment considerations

- Potential inclusion of 965 income
- Is there “factor relief” for the U.S. shareholder?
 - If there is no statutory factor relief, such relief may nevertheless be required by the U.S. Constitution?
 - How would factor relief work? Remember, the 965 inclusion is of deemed repatriated earnings from the past 30+ years.

GILTI

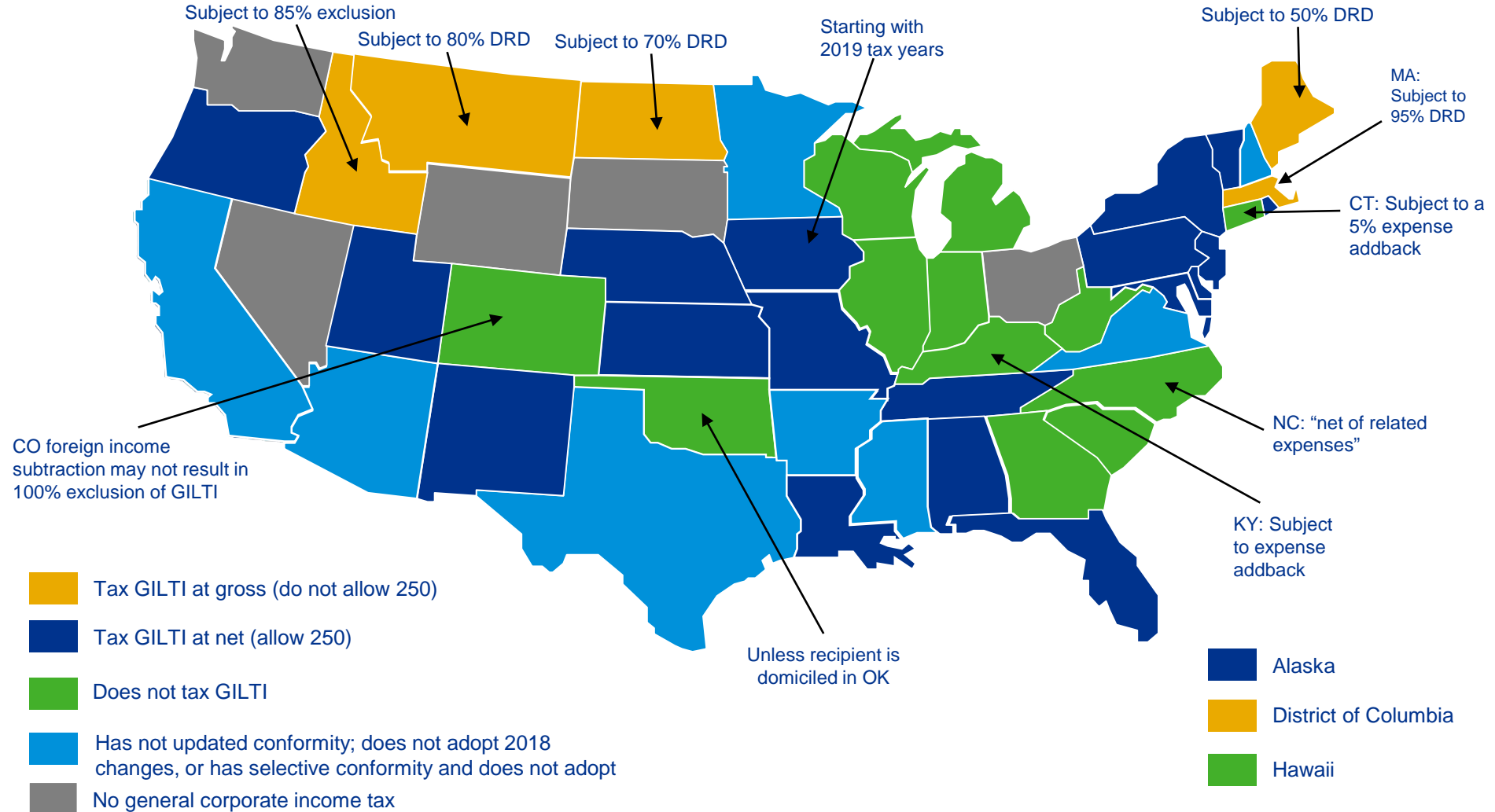
Tax reform impact – GILTI

What are the state issues?

- Does the state conform to new section 951A?
- Is any GILTI included in the state tax base?
- If included in the state tax base, does GILTI receive receipts factor representation?
- How is GILTI sourced if included in the receipts factor? See a few approaches.....
- Is there any other means of excluding GILTI?
- Is there a foreign commerce clause argument that the income should be excluded or that factor relief is needed?
- How does the GILTI deduction work for state purposes?
- If there is an exclusion for GILTI, will the taxpayer still get the section 250 deduction?
- The same issue will present itself with the deduction being allowed under Code section 250 to reduce the tax rate on Foreign Derived Intangible Income (FDII)

State taxation of GILTI (as of 1/20/2019)

Not considering Foreign Commerce Clause and assuming 100 percent ownership



Section 163(j)

IRC Section 163(j) Limitation Calculation

Issues to be addressed:

“Adjusted Taxable Income” for state purposes that is different from the federal?

Limitation applied at separate company level or combined group level (i.e., who is the “taxpayer”?)

What happens when combined group is different than consolidated group?

—Interplay of limitations for interest between related members in states with special in lieu of industry taxes such as insurance and telecommunications.

Is disallowed interest a tax asset of the group or a particular entity? How is it to be allocated among group members (e.g., if an entity leaves a group)?

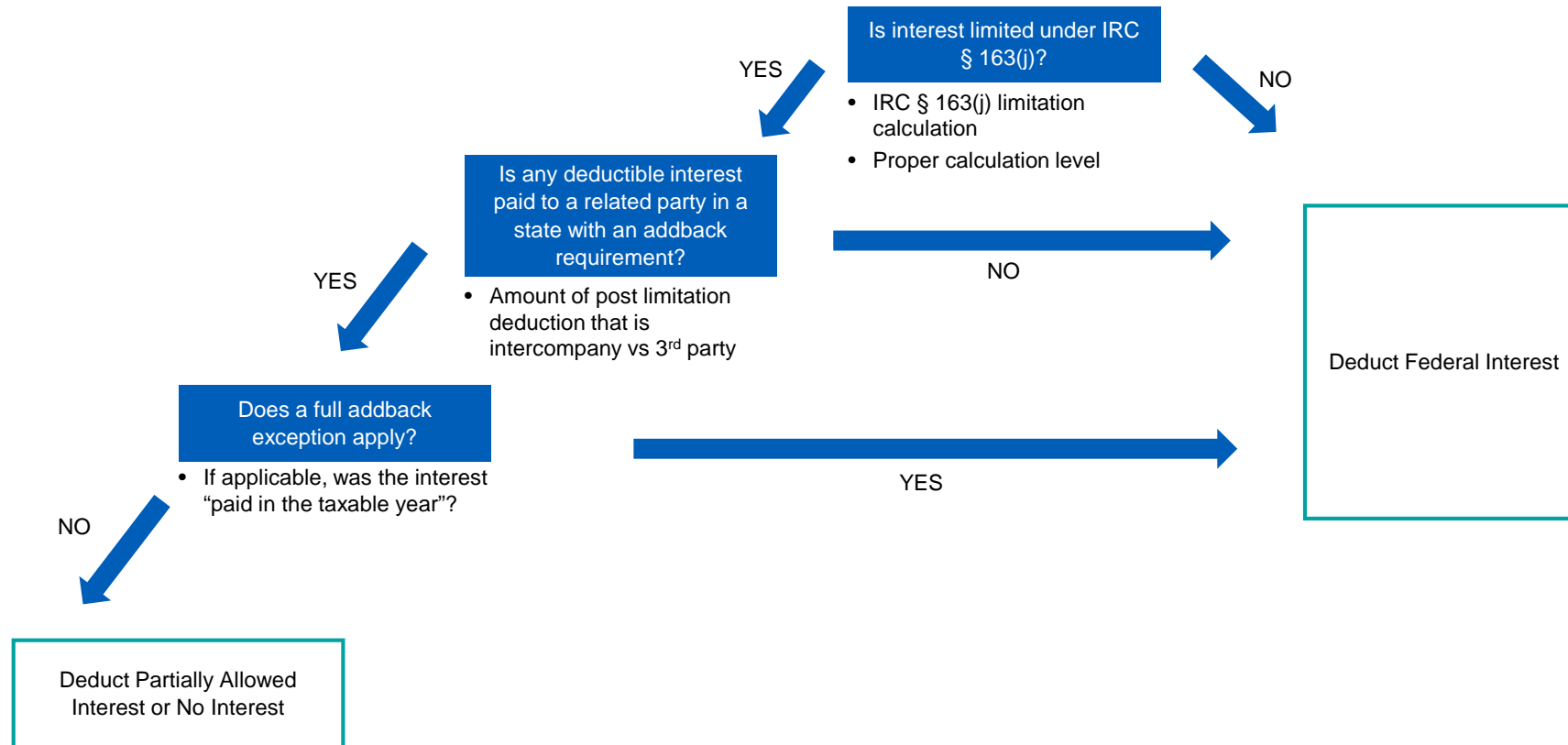
How much interest is subject to state addback provisions where a taxpayer has both intercompany and third party interest expense subject to limitation?

What if the interest expense is treated as a non-business expense for state tax purposes?

How are federal carryovers amounts adjusted for separate state limitations?

2017 Federal Tax Act—Multistate Implications

Interaction of IRC § 163(j) and State Intercompany Addback Rules



Thank you