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GILTI, FDII, BEAT & Repatriation: What the States Should be Doing in Response to the New Territorial Tax System Created by the TCJA

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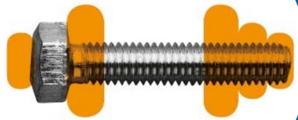
Agenda



The Nuts and Bolts of the TCJA

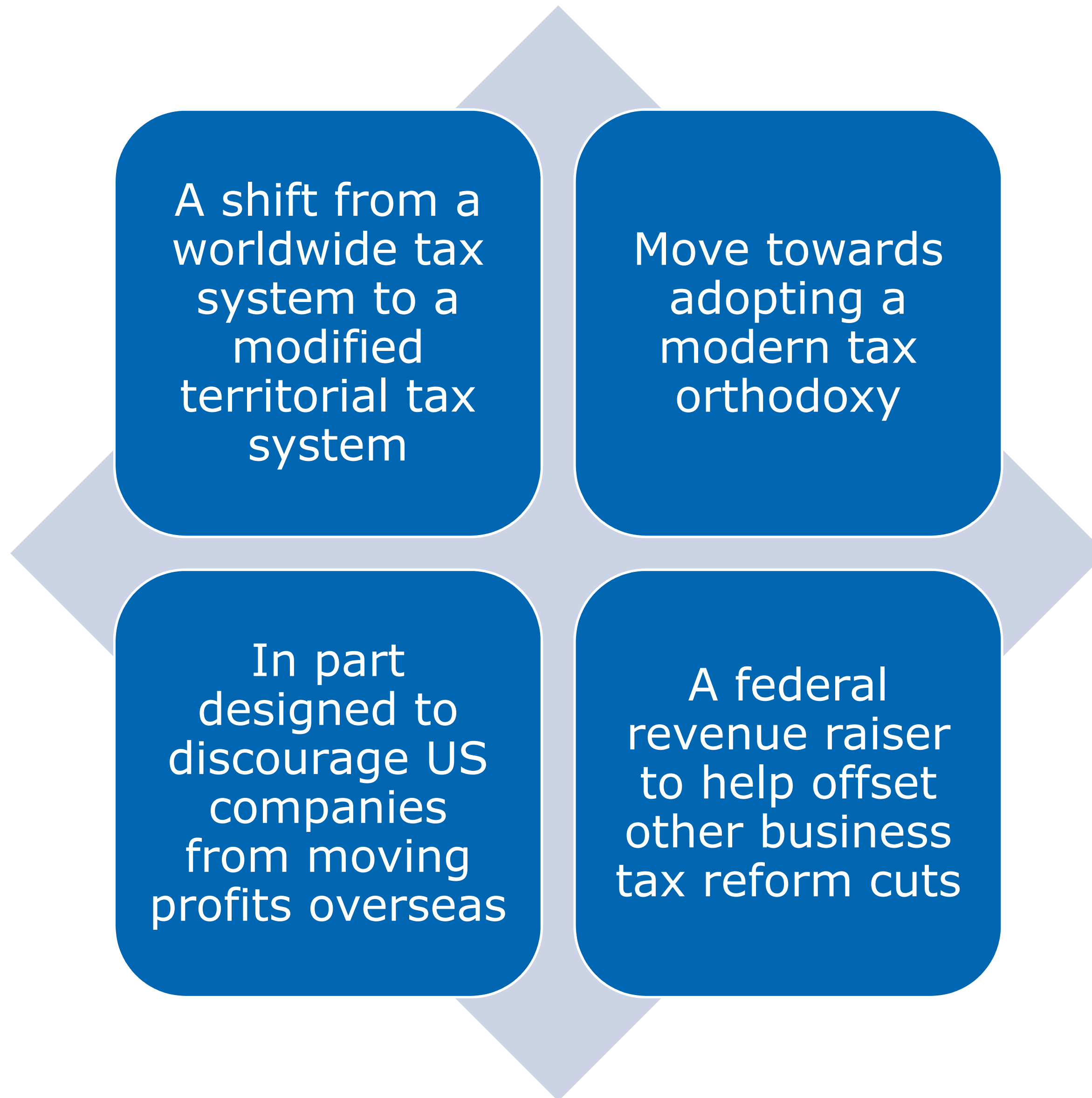
How Should the States React?

Appendix

The Nuts and Bolts of the TCJA

International Tax Provisions

The Purpose of the TCJA's International Tax Provisions



How Is It Done? – Key International Tax Provisions

Exemption of foreign dividends

One-time repatriation transition tax (Transition Tax)

Tax on global intangible low-taxed income (GILTI)

Foreign-derived intangible income deduction (FDII)

Base erosion and anti-abuse tax (BEAT)

How Should the States React?

Give Timely Guidance

State Corporate Income Tax Conformity to the IRC

As of April 9, 2019

Extend Filing Deadlines

Or Waive Late Filing Penalties

Transition Tax

- Applies on the last tax year beginning before January 1, 2018
- **Federal Tax**: April 16, 2018 (without extension)
- **State Tax**: **32 states have the same federal tax due date**
- **Form 10-K**: April 2, 2018
  - 90 days after end of fiscal year end

GILTI FDII BEAT

- Applies after December 31, 2017
- **Tax**: April 15, 2019 (without extension)
- **State Tax**: **32 states have the same federal tax due date**
- **Form 10-K**: April 1, 2019
  - 90 days after end of fiscal year end

Assuming a non-accelerated calendar year end publicly reported C-corporation taxpayer

Don’t Adopt the Provisions

- Composition of deemed income
  - Non-US activities
  - Not necessarily income from intangibles
    - E.g., manufacturing companies with depreciated property
- Conforming could lead to more aggressive state taxation than federal taxation
  - E.g., no conformity to foreign tax credits, federal tax rate reduction and FDII
- Constitutional concerns (i.e., *Kraft*)
- Risk of overlap with other state tax provisions, such as addbacks
- Inconsistent with the goals of the TCJA
- Practical complications

Don’t Adopt the Provisions (cont’d)

Transition Tax

- **100% foreign income/DRD/subpart F income modification applies**
  - Alabama, Arizona, Connecticut, Georgia, Michigan, Virginia
- **No conformity to or decouples from IRC § 965**
  - Arkansas, California, Hawaii, New Hampshire, South Carolina, Wisconsin
- **Excluded from income**
  - Florida, New York, Tennessee

GILTI / FDII

- **100% foreign income/DRD/subpart F income modification applies**
  - Michigan, Virginia (GILTI specific subtraction modification)
- **No conformity to or decouples from IRC § 951A / IRC § 250**
  - California, Hawaii, Mississippi, New Hampshire, Wisconsin
- **Excluded from income (GILTI)/No Deduction (GILTI/FDII)**
  - Indiana, Kentucky, North Carolina

BEAT

- **To date, no state has adopted BEAT**

If Adopting, Adopt the Entire Scheme

- Mechanical linkage creates partial conformity
- Inconsistent with the goals of the TCJA
- Asymmetries with the US' international tax structure
  - Should respect the federal modified territorial tax system
- Not conforming to the other mechanisms could lead to more aggressive state taxation than federal taxation
  - E.g., no conformity to foreign tax credits, federal tax rate reduction and FDII
- Repeal overlapping foreign source income related measures
  - E.g., addback provisions, tax haven designations
- Constitutional concerns (i.e., Supremacy Clause)

If Adopting, Adopt the Entire Scheme (cont’d)

Transition Tax

- **Apply the IRC § 965(c) deduction**
  - Alabama, Georgia, Illinois, Missouri, Nebraska, Oklahoma, Vermont
- **Apply the state’s dividends received deduction**
  - Alabama, Georgia, Illinois, Missouri, Pennsylvania
- **8 year payment schedule**
  - Oklahoma, Utah

GILTI / FDII

- **Apply the IRC § 250 deductions (GILTI & FDII)**
  - Form mechanics (line 28 v. line 30)
  - New Jersey v. New York
- **Apply the state’s dividends received deduction**
  - Georgia, Indiana, Kentucky, Massachusetts, North Dakota, Pennsylvania

If Adopting, Do Not Forget the Unitary Business Principle

- States should only be able to tax income imputed from a foreign entity if that foreign entity was unitary with the domestic entity subject to state taxation
- Regarding the transition tax, there are complications with a foreign entity that may have been unitary for some, but not all years

Restrain Use of Retroactive Legislation

- To the extent a state adopts the TCJA provisions, use of retroactive tax legislation should be limited to corrective, curative legislation within a limited time period
  - E.g., Idaho enacted H.B. 183, which allows deductions under IRC § 245A and 250 retroactively to January 1, 2018 and IRC § 965 retroactively to January 1, 2017
- Minnesota (H.F. 2125):
  - One proposal would retroactively impose transition tax and retroactively tax GILTI
  - A subsequent proposal would retroactively impose transition tax, and would include GILTI-generating CFCs in combined return

Provide Factor Representation

- *Container*: "fairness in an apportionment formula" requires that "the factor or factors used in the … formula must actually reflect a reasonable sense of how income is generated."
  - *Mobil*: Must "tak[e] the payroll, sales and property of the [dividend] payor corporations into account."
- Alternatives for providing factor representation
  - Include gross factors of CFCs generating GILTI
    - Look through to underlying CFCs generating income
  - The "Detroit formula"
  - Place net GILTI amount in denominator
- Consider different approaches depending upon facts surrounding CFCs generating GILTI for a state taxpayer
  - Additional complications related to the transition tax, which potentially represent decades of unrepatriated gains

Provide Factor Representation (cont'd)

- **New York, Maine, North Dakota***
  - Include net GILTI amount in denominator
- **Indiana**
  - Include net amount (GILTI less state DRD) in denominator
- **New Jersey**
  - Allocate GILTI using a separate factor "equal to the ratio of New Jersey's gross domestic product (GDP) over the total GDP of every U.S. state (and the District of Columbia) in which the taxpayer has economic nexus"
- **Connecticut, Kentucky, Massachusetts**
  - Exclude GILTI from the apportionment formula

* For water's-edge filers

Worldwide Combined Reporting Considerations

- States moved away from mandatory worldwide combined reporting in the 1980s because it was bad state tax policy
  - Abandoned under pressure from the federal government and foreign nations
  - Foreign nations authorized retaliatory tax treated against US multinationals in response to worldwide combined reporting
- Worldwide combined reporting is out of sync with federal tax policy and international approaches to taxing foreign source income
  - OECD’s long term trend away from a worldwide system towards a territorial system

Appendix

Foreign-Source DRD – IRC § 245A

Overview

- A 100% DRD or "participation exemption" equal to the "foreign-source portion" of dividends a US taxpayer receives from a 10%-owned foreign corporation
- Reduces the basis in stock in foreign corporations to reflect distributions eligible for DRD in calculating losses
- Requires recapture of net losses of a foreign branch that is transferred to a foreign corporation – an expansion of existing branch loss recapture rules

Transition Tax – IRC § 965

Overview

- One-time transition tax on untaxed foreign earnings of certain foreign subsidiaries of US companies by deeming those earnings to be repatriated
- Amounts are included in a taxpayer's gross income as Subpart F income
- The amount taxed is determined based on foreign subsidiaries' E&P, the greater amount measured on one of two testing dates
- The tax rate on amounts attributable to cash and cash equivalents is 15.5%, and any remaining E&P is taxed at an 8% rate. Effective rates are achieved through a partial deemed DRD
- Tax may be paid in installments over an eight-year period
- Tax base is reportable on a separate "IRC 965 Transition Tax Statement"
- Tax liability reported on Line 31 of Page 1 of Form 1120 (total tax)

GILTI – IRC §§ 951A, 250

Overview

- Imposes tax on a US taxpayer's Global Intangible Low Taxed Income (GILTI), which approximates the taxpayer's allocable share of amounts earned by CFCs outside the US in excess of routine returns on tangible property
- Included in federal taxable income in a manner similar to Subpart F income
- A 50% deduction for such income is provided, generally resulting in a US tax rate of 10.5% for GILTI income, reduced by 80% of related foreign tax credits (FTCs), subject to ordinary limitations

FDII – IRC § 250

Overview

- Permits domestic corporations to deduct 37.5% of their Foreign Derived Intangible Income (FDII) which calculates an amount similar to GILTI and multiplies that amount by the fraction of the income earned in the US that is attributable to property sold or licensed to a non-US person for foreign use or to services provided outside the US
- The FDII provision generally results in a reduced effective tax rate of 13.125% on FDII
- GILTI and FDII work in tandem – GILTI discourages intangibles in low-tax foreign jurisdictions and FDII encourages intangibles in the US

BEAT – IRC §§14401, 59A

Overview

- Generally imposes a 10% minimum tax (5% in 2018) on a taxpayer's income determined without regard to tax deductions arising from base erosion payments (including the portion of a taxpayer's net operating loss (NOL) deduction treated as related to base erosion payments), which generally cannot be reduced by credits other than, through 2025, the research credit under IRC § 41(a) (R&D credit) and 80% of certain other credits

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