Federal Tax Changes Rocking the SALT Landscape

TEI New Jersey Chapter
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Agenda

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- Repatriation Transition Tax
- Global Intangible Low Tax Income
- Foreign Derived Income Inclusion
- Cost Recovery
- Interest Expense Deduction Limitation

General Overview

- The state impact of nearly all TCJA provisions is conformity dependent
  - Floating conformity – selective
  - Static conformity – rolling, annual, fixed
- Filing methodology will impact the application of TCJA
  - Separate v. combined
  - Composition of group
  - Definition of state taxable income (world-wide v. federal taxable income)
  - Application of the federal consolidated return rules

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Repatriation Transition Tax

Transition Tax – IRC Sec. 965

- General concepts:
  - One time tax on untaxed foreign earnings of certain foreign subsidiaries (accumulated post-1986); deemed repatriation
  - Included in Taxpayer's gross income as Subpart F income
  - Potential foreign commerce clause issues (Kraft)
- Repatriation
  - Mitigated to extent of state's DRD
  - Factor representation/distortion
  - Character of income
  - Previous taxation of income
    - World-Wide Combined Reporting
    - Taxation of world-wide income
    - Taxation of effectively connected income without treaty exemptions

Transition Tax – IRC Sec. 965 (cont'd)

- States responses:
  - Included in Income After Deduction (IRC § 965(a) inclusion and IRC § 965(c) deduction).
  - Included in Income Without Deduction (IRC § 965(a) inclusion without IRC § 965(c) deduction)
  - Excluded from Income
  - Installment payments allowed vs. not allowed

- Most Recent Developments
  - OR tax haven credit (10/12/18)
  - ME (9/12/18) – 20% of 965 income taxable; 50% amount of GILTI pre-apportionment
  - NJ (10/5/18) – No 965 conformity but 965 income taxable with 95% DRD; surtax

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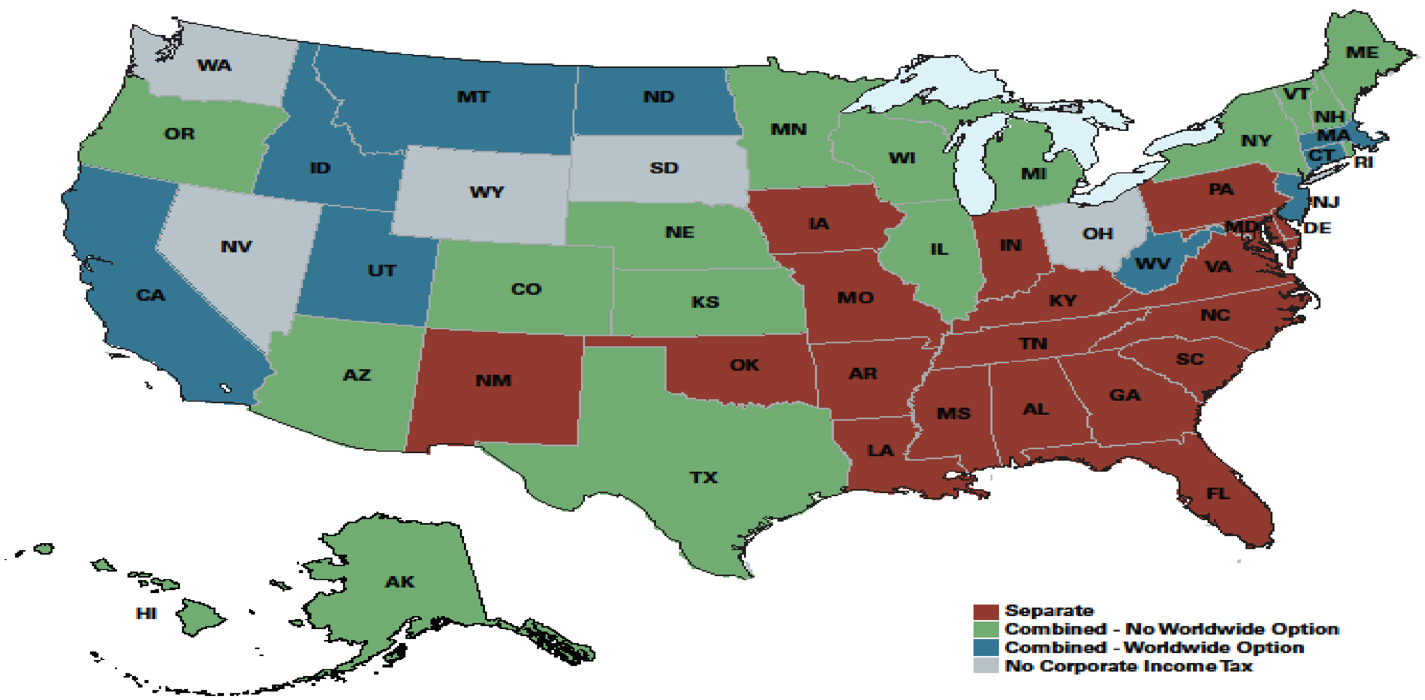
Effect of Combined Reporting Trend



Note: Elective, industry-specific, and like provisions are not taken into consideration.
This map is intended to represent general filing methods.

Global Intangible Low Tax Income
IRC §§ 951A, 250

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Global Intangible Low Taxed Income and Foreign Derived Intangible Income – IRC Secs. 951A, 250

- "GILTI" – Name is a misnomer – targeted at all low taxed income outside the US, from intangibles or otherwise
- General Concepts:
  - Essentially the moving forward version of 965.
  - Unclear that it's subpart F income at all despite some states leaping to that conclusion and murkiness of federal legislation (housed in Subpart F income IRC statutes)
  - FDII partial offset to GILTI
- GILTI Conformity with vs. without deduction; impact at state level
  - State tax policy behind conformity – completely arbitrary vs. federal reform to fund corporation tax rate cuts
  - Factor representation

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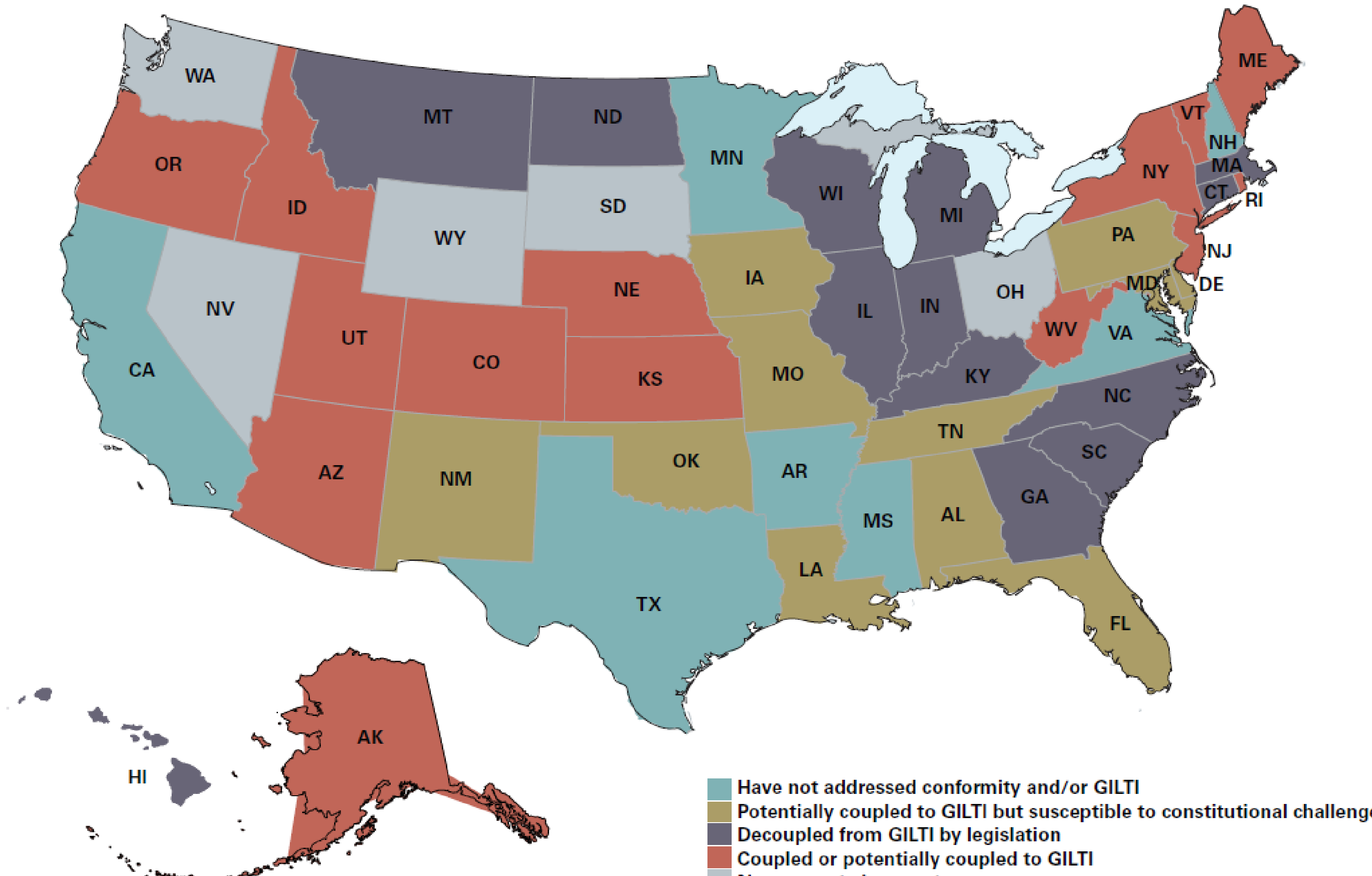
Global Intangible Low Taxed Income and Foreign Derived Intangible Income – IRC Secs. 951A, 250



Global Intangible Low Taxed Income and Foreign Derived Intangible Income – IRC Secs. 951A, 250

<u>State Tax Implications</u>

- Theoretically inconsistent with formulary apportionment
- Conformity
  - Application to the Federal Consolidated Group will cause filing method inconsistency
  - More or less expansive definition of federal taxable income
  - Worldwide group filers
- Proper calculation of GILTI for state tax purposes
  - Inclusion of GILTI in state taxable income (DRDs, subpart F treatment)
  - Inclusion of deduction to effect rate reduction
- Apportionment
  - May very well create dilution of the apportion factors
  - Addition of foreign factors to the denominator, no correlative numerator increase

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Cost Recovery – Immediate Expensing
IRC § 168(k)

Bonus Depreciation – IRC Sec. 168(k)

- IRC § 168(k) expanded to include full expensing of cost of new and used qualified property between 9/27/17 and 1/1/23
- Basis differences galore
- Every transactions must be reviewed for state tax purposes
- Decoupling from accelerated, bonus and full cost recovery has created significant differences between state and federal basis.
  - State basis will always be better than federal basis
  - Independent analysis is critical to reducing the gain on transactions

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Interest Expense Deduction Limitation
IRC § 163(j)

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Interest Limitation – IRC Sec. 163(j)

<u>Federal Tax Treatment</u>

- Limits deductibility of interest expense to 30% of adjusted taxable income
- Does not deem the interest expense not paid (recipient still has income)

<u>State Tax Issues</u>

- Conformity
- Calculation of the interest expense limitation (filing methodology)
  - Multiple state groups will create double taxation of income
- Impact on related party addback provisions
  - Deductibility – Is it still an "otherwise deductible interest expense"
  - Exceptions – How do you calculate the exceptions to the addback?

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