

State and Local Tax Implications of International Tax Reform and the CARES Act

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Fredrikson
& BYRON, P.A.

Today's Panelists and Moderator



Kenneth Levinson
612.492.7122
klevinson@fredlaw.com



David Tibbals
701.237.8403
dtibbals@fredlaw.com



Kyle Brehm
612.492.7198
kbrehm@fredlaw.com

Agenda

- Overview of the Tax Cuts and Jobs Act (TCJA)
- Overview of CARES Act Changes to the TCJA
- Issues of Friction Between Federal and State Law
 - Conformity
 - International Provisions
 - The CARES Act
- Federal Administrative Relief Due to COVID
- Other COVID-related Federal and State Concerns

Polling Question 1

Key Tax Law Changes in the Tax Cuts and Jobs Act

- Lower Tax Rates
 - TCJA includes a reduction in corporate and individual income tax rates (40% cut for corporations, 5% for individuals).
- Base Broadening
 - Lower rates are somewhat offset by a wide range of base broadeners extending to both individual and business taxation.

Key Tax Law Changes in the Tax Cuts and Jobs Act (cont.)

- International Tax Reform
 - TCJA partially shifts U.S. corporations (not individuals) from a worldwide tax system toward a territorial tax system.
 - TCJA imposes a one-time transition tax on previously untaxed accumulated foreign earnings.
 - TCJA also introduces a number of new tax provisions intended to tilt the playing field to favor domestic commerce over foreign commerce.

Overview of Tax Cuts and Jobs Act (TCJA)

- Provide a globally competitive U.S. corporate tax rate and mitigate double taxation
- Dissuade U.S. companies from “inverting” (changing domicile to low rate jurisdictions (e.g., Ireland))
- Trigger repatriation of overseas cash by U.S. companies for capital and wage investment in the U.S.

Overview of TCJA (cont.)

- Incentivize foreign companies to increase investment in U.S.
- Ensure that all corporate earnings – regardless of location – are subject to a minimum level of taxation
- Prevent foreign parent companies and foreign affiliates from base-eroding earnings of U.S. companies
- No change in U.S. tax treaties

Overview of TCJA (cont.)

- Lower corporate tax rate to 21%, improve international competitiveness of U.S. business
- Implement limited “territorial regime” for non-U.S. earnings of 10%-owned foreign corporations
- Impose one-time transition tax on previously untaxed non-U.S. earnings abroad (many taxpayers utilize annual 1/8 payment option)

Overview of TCJA (cont.)

- Apply a minimum tax to U.S. Shareholders of Global Intangible Low-Taxed Income (“GILTI”) to certain CFC earnings in a foreign jurisdiction
- Special U.S. deduction for U.S. corporations for Foreign-Derived Intangible Income (“FDII”) for income generated by U.S. sales of property to foreign persons, services fees from foreign persons, or IP license fees paid by foreign persons
- Apply Base Erosion and Anti-Abuse Tax (“BEAT”) within large multinational corporate groups to certain cross-border payments to non-U.S. affiliates

Overview of TCJA (cont.)

- Limitation on deduction of interest expense
- Four separate “buckets” now required within Section 904 foreign tax credit limitations calculations
- Changes to Subpart F rules, including ownership attribution rules and permitted inbound U.S. lending
 - Deletion of Section 954(b)(4) to permit “downward attribution”
 - Increase in PTI (due to Section 965) means more tax-free repatriation of funds to U.S. from CFCs
 - IRS regs now reduce “U.S. Property” inclusion under Section 956 if any “increase” in such Property would have been exempt if distributed “hypothetically” under Section 245A

Overview of TCJA (cont.)

- Changes to taxation of sales of U.S. partnership interests by foreign partners
 - Now treated as ratable asset sales (codified Rev. Rul. 91-32, vs. *Grecian Magnesite*, 2017 U.S. Tax Court case)
 - Subjects foreign partners to US ECI (and US tax return/tax payment) obligations

Overview of CARES Act Changes to TCJA

- No overall changes in *federal policy* focus internationally of TCJA
 - Same lower tax rates, base broadening changes
 - Same partial territorial tax system (for U.S. corporate taxpayers owning at least 10% of the foreign corporate distributor)
 - No change in Section 965 repatriation tax provision
 - Same principal provisions to assist US businesses with international competitiveness, encouragement of domestic commerce and manufacturing
 - Left GILTI, FDII, BEAT regimes in place

Overview of CARES Act Changes to TCJA (cont.)

- Provides certain statutory relief for business taxpayers
 - Corporate NOL changes to TCJA
 - 2018-2020 NOLs can be carried back 5 years, and forward indefinitely.
 - 80% TCJA cap applies only to TYs beginning *after* 2020.
 - Non-corporate NOL changes to TCJA
 - “Excess business loss” deduction cap (\$250,000 / \$500,000) applies only to TYs beginning after 2020.
 - Allows for relief from the Section 382 limitation
 - Treasury may rule that federal acquisition of equity pursuant to CARES is not an ownership change.

Overview of CARES Act Changes to TCJA (cont.)

- Provides certain statutory relief for business taxpayers (cont.)
 - Modifies Section 163(j) TCJA limits in business interest expense
 - Changes corporate cap on ATI to 50% for 2019 and 2020
 - Allows comparable benefit for partnerships but *only* for 2020
 - Corrects technical definition *retroactively* of “qualified improvement property” to be considered 15-year depreciable property
 - Thus, QIP is also, retroactively, allowed bonus depreciation
 - Clarified that QIP must be for taxpayer improvements (not purchased property)

Overview of CARES Act Changes to TCJA (cont.)

- Provides certain statutory relief for business taxpayers (cont.)
 - Deferral of certain payroll taxes due in 2020
 - 50% due by 12/31/21, 50% due by 12/31/22
 - Employer credit against employment taxes for certain qualified wages
 - If business is closed/suspended, or gross receipts less than 50% vs. same 2019 quarter, due to COVID
 - Accelerates post-AMT recovery of minimum tax credits
 - Increases limitations on corporate charitable contribution deduction
 - Provides that forgiveness/cancellation of Payroll Protection Program loans will generally not be treated as cancellation of debt income

Overview of CARES Act Changes to TCJA (cont.)

- Provides certain statutory relief for individual taxpayers
 - Refundable credits
 - \$1200/\$2400 per single/joint + \$500/child, with phase-outs
 - Considered *non-taxable* federally
 - Modest above-the-line (\$300) Charitable contributions (if don't itemize)
 - Raises 2020 cap on certain itemized charitable contributions for individuals
 - Max to 100% of AGI

Polling Question 2

Issues of Friction Between Federal and State Law: A Question of Conformity

- Methods of adoption of the IRC
 - Rolling conformity: Automatic adoption of IRC changes as they are made
 - Ex: Missouri, North Dakota, Iowa (new for 2020!)
 - Static conformity: Specific action required to adopt IRC as of a date certain
 - Ex: Minnesota (currently adopts IRC as of 12/31/18)
 - No general conformity: A few states pick and choose IRC provisions
 - Ex: Pennsylvania

Issues of Friction Between Federal and State Law: A Question of Conformity (cont.)

- Decoupling
 - Regardless of method of adoption, states specifically deviate from certain IRC provisions for their own policy reasons
 - Ex: Most states decouple from bonus depreciation

Potential State Impact of Business Tax Reform Provisions



Federal	States
Corporate tax rate reductions	States have own rates
Special pass through entity deduction	Potentially impacts minority of states tied to federal “taxable income” for PIT purposes
Limitation of net interest deductions that exceed 30% of adjusted taxable income	State conformity (uncertain application to state filing groups)
Fully expensed investments	2/3 of states opted out of bonus depreciation
Broadened tax base including repeal of Sec. 199 domestic production deduction	State conformity (although many states already opted out of the domestic production deduction)
Limit NOL deductions	Most states have their own NOL provisions
Amortization of research and experimental expenditures	State conformity

Potential State Impact of Business Tax Reform Provisions



Federal	States
100 percent dividends-received deduction	Most states have their own DRDs
Transition tax on “deemed” repatriated earnings	One-third of states tax some portion of Subpart F income and/or foreign dividends.
Tax on global intangible low-taxed income (GILTI) earned by CFC	Likely state conformity (but constitutional limitations)
Deduction of 50% of GILTI income	Partial state conformity (but “special deduction” linkage issues)
Reduced tax on foreign-derived intangible income (FDII) of U.S. corporation	Partial state conformity (but “special deduction” linkage issues)
Base erosion anti-avoidance tax (BEAT)	Separate tax not in federal taxable income
Longer amortization schedule for foreign research and experimentation (15 years)	Likely state conformity (but constitutional issues)

Top Increases / Decreases in Federal Corporate Tax Base, Potential State Conformity



Business Tax Provision	% Change in Federal Corp Tax Base	State Conformity
One-time transition tax on unrepatriated foreign earnings	+ 17.9%	Limited conformity
Global intangible low-taxed income (GILTI) inclusion	+ 5.9%	Significant conformity
Net interest expense limitation (30% of ATI)	+ 5.8%	Conformity
Modification of net operating loss deduction	+ 5.3%	Non-conformity
Base Erosion and Anti-Abuse Tax (BEAT)	+ 4.0%	Non-conformity

Top Increases / Decreases in Federal Corporate Tax Base, Potential State Conformity



Business Tax Provision	% Change in Federal Corp Tax Base	State Conformity
Amortization of research and experimental expenditures	+ 2.9%	Conformity
Repeal of domestic production activities deduction	+ 1.9%	Partial conformity
Foreign derived intangible income (FoDII) deduction	- 1.7%	Partial conformity
Expensing provided under Section 168(k) bonus depreciation	- 1.8%	Partial conformity
Global intangible low-taxed income (GILTI) deduction	- 3.0%	Partial conformity
100% foreign DRD	- 5.9%	Limited conformity

Issues of Friction Between Federal and State Law: A Question of Conformity (cont.)

- State treatment of GILTI, FDII, BEAT tax regimes/impacts
- State treatment of deemed Repatriation income (Section 965) and impact of related 1/8th Federal tax payment election
- State impact of Section 245A DRD for dividends to U.S. corporations from 10%-owned foreign corporations
- Changes in Federal Foreign Tax Credit rules
 - Denial of FTCs for Section 245A excluded dividends
 - Changes to FTC eligibility, amounts for GILTI
 - Virtual elimination of “deemed paid” FTCs (except for corporate U.S. Shareholders under Section 951)




Issues of Friction Between Federal and State Law: U.S. Business Conduct by Foreigners

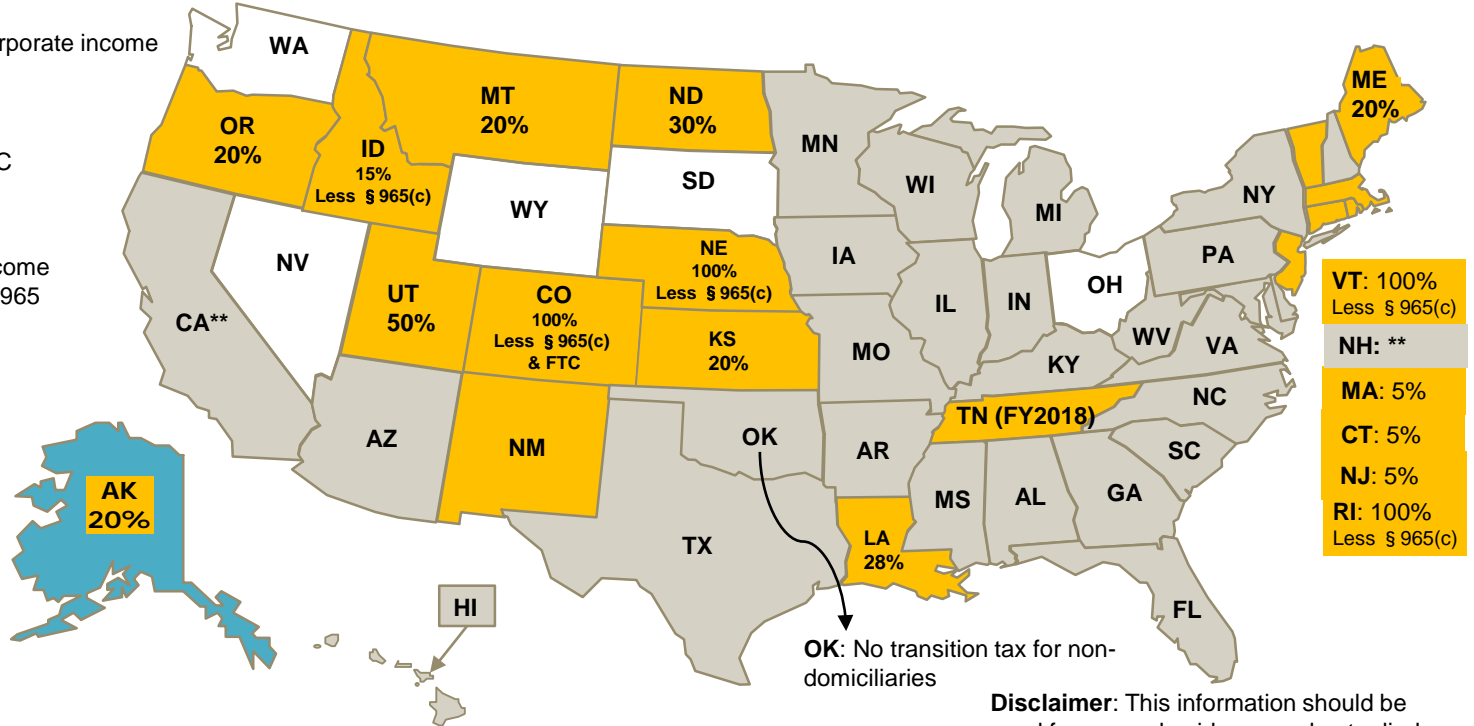
- States are not directly bound by U.S. tax treaties
 - Applicability varies depending upon the scope and application of state conformity
- U.S. treaties address bilateral *income* tax issues
- *Compare*: impact of state sales/use taxes, property taxes on non-US persons
 - These control for state tax purposes regardless of *income* tax applicability of treaty to taxpayer (U.S. or non-U.S.)

Issues of Friction Between Federal and State Law: U.S. Business Conduct by Foreigners (cont.)

- Query: emerging “economic nexus” implications on state taxation of non-U.S. persons, businesses
 - *Consider*: international internet-ordered products shipped to U.S. persons (e.g., COVID masks, ventilators, vaccines, swabs, test kits, etc.)
- What about *Container Corp* case: “A state may not, when imposing an income-based tax, ‘tax value earned outside its borders.’” 463 U.S. at 164

One Time Issue: State Corporate Income Tax Conformity to IRC § 965 Repatriated Income*

-  State does not impose a corporate income tax
-  0%: State does not impose corporate income tax on IRC § 965 repatriated income
-  State imposes corporate income tax on some or all of IRC § 965 repatriated income



* Based generally on 80% or more direct corporate ownership of foreign corporations. Other rules may apply for smaller % ownership or PIT purposes.

**No conformity update but taxes a portion of foreign dividends (when distributed) for water's edge filers.

Source: Council On State Taxation

Disclaimer: This information should be used for general guidance and not relied upon for compliance. Check current rules in the states of interest to you.

What about when you bring actual cash back?

Minnesota decided NOT to tax the deemed repatriated income from overseas.

From MN DOR website:

Does Minnesota tax actual repatriated income previously taxed under Internal Revenue [-] Code (I.R.C.) sections 965 or 951A for C corporations?

No. Minnesota does not tax income excluded at the federal level as previously taxed under I.R.C. sections 965 (deferred foreign income) or 951A (global intangible low-taxed income) for C corporations.

Nebraska

- Nebraska DOR issued guidance last December stating that it conforms to taxing Section 965(a) deemed income inclusion and allowing Section 965(c) deduction.
- But...
- It also stated that net Section 965 inclusion income is not a foreign dividend eligible for DRD.
- Advises T/P's to include legal analysis supporting its position if it wishes to treat deemed income as foreign dividend.

Iowa

- Iowa did not conform to updated IRC for 2017 tax year and would NOT tax Section 965 deemed repatriated income.
 - What about taxing actual cash dividends brought back to U.S.? Prohibited since previously taxed income?

- Absent further legislative action, Iowa WILL conform to the GILTI/FDII provisions beginning with the 2019 tax year.
 - Constitutional issue by not granting sales factor relief?

Polling Question 3

Issues of Friction Between Federal and State Law: Conforming to the CARES Act

- Net operating loss amendments
 - Carryback – Section 172(b)
 - Allows new 5-year carryback of NOLs arising in tax years beginning after 12/31/17 and before 1/1/21
 - Corrects a drafting error in TCJA, clarifying that NOLs arising in tax years beginning in 2017 are subject to the pre-TCJA rules
 - Offset – Section 172(a)
 - Suspends the TCJA 80% offset limitation until 2021, but applies it beginning with NOLs arising in tax years beginning in 2018
 - Conformity to Section 172 is complicated – states often modify/decouple
 - Impact of federal amendments to take advantage of carryback

Issues of Friction Between Federal and State Law: Conforming to the CARES Act (cont.)

- Business interest expense deduction limits – Section 163(j)
 - Raises one component of the TCJA limits to 50% of adjusted taxable income (was 30%)
 - Applies to tax years beginning in 2019 and 2020
 - Generally applies to S-corps, but not to partnerships in 2019
 - Instead, a special rule treats 50% of 2019 excess business interest allocated to a partner as paid or accrued by the partner in its first tax year beginning in 2020
 - Allows a taxpayer to use 2019 ATI for purposes of computing the deduction for the 2020 tax year
 - Fewer states decouple from Section 163(j), but state-specific reporting rules complicate tracking

Issues of Friction Between Federal and State Law: Conforming to the CARES Act (cont.)

- Correction of the “retail glitch” – Section 168
 - Retroactively classifies qualified improvement property (QIP) placed in service after 12/31/17
 - MACRS: 15-year property (Section 168(a))
 - ADS: 20-year property (Section 168(g))
 - Allows for 100% bonus depreciation to QIP, effective beginning with tax years beginning in 2018 (Section 168(k))
 - States tend to decouple from Section 168(k), but follow federal property life classifications
 - State impact of accounting method change
 - Claim missed bonus depreciation by amending federal return or filing Form 3115

Issues of Friction Between Federal and State Law: Conforming to the CARES Act (cont.)

- CARES Act relief measures
 - Deferral of 2020 payroll tax payments
 - 50% due by 12/31/21, 50% due by 12/31/22
 - Employee retention credit
 - Provides temporary (and refundable) credit against payroll taxes based on 50% of wages for certain employers in 2020
 - Applies to businesses subject to government-mandated closures and businesses experiencing a decline of 50% in gross receipts from relevant quarter in prior year
 - Expense reductions result in lesser deductions, increasing state taxable income

Polling Question 4

Federal Administrative Relief Due to COVID

- IRS Notices have provided automatic extensions (e.g., Notices 2020-18, -20, -23, etc.)
 - “Any” taxpayer “affected by COVID” now has a variety of automatic *federal* relief/extension provisions applicable for obligations otherwise due **“on or after” April 15, 2020, and “before” July 1, 2020**
 - Filing returns, schedules, forms, extensions, etc. within those dates are automatically extended to July 15, 2020 without further T/P action or request (for complete list of forms, etc., see Notice 2020-23, Section III B)
 - Applies also to estimated tax payments otherwise due 4/15 or 6/15
 - Finally, relief provisions also extend filing obligations within that same period, such as filing Tax Court petitions, required review of Tax Court decisions filing for refund claims, etc.

Federal Administrative Relief Due to COVID (cont.)

- Foregoing automatic extensions do NOT apply:
 - To grant required further extensions (if filed by July 15) beyond normal statutory/regulatory extension date (e.g., individual extension after 7/15 cannot go beyond Oct. 15, 2020)
 - To excuse or change requirement to make any automatically extended/required payment on/by July 15, 2020:
 - If T/P seeks further extension to file beyond 7/15, must still pay estimated tax, etc., by 7/15
- State impacts of IRS extensions for tax return filing/tax payment deadlines

Transfer Pricing: *Still* Applicable, But May Be Impacted by COVID...

- “Contemporaneous Documentation” still required, must be “in existence” *when the return is filed...*
 - COVID-19 automatic filing extensions
- Updates/revisions to studies/documentation required
 - Substantiate why T/P “reasonably concludes” its method is – and continues to be – the “most reliable measure” of arm’s length price
 - Impact of “comparable” market pricing changes due to COVID impact?

Other COVID-related Federal and State Concerns

- COVID-triggered state (and federal) “residency” questions: obligatory extended physical “presence” impacts
 - States have begun to indicate that nexus will not be asserted solely due to employees telecommuting during the pandemic
 - Impact on state apportionment
 - Withholding requirements
- Electronic signatures on returns, required filings

Polling Question 5

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612.492.7122
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Mark your calendars for the next State Tax Webinar on Thursday, August 13.