State Corporate Income Tax Impacts of GILTI: Challenges and Opportunities

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Agenda

- The State Taxation of GILTI

- Factor Representation and Constitutional Issues Relating to State Taxation of Foreign Source Income

- Future Direction of State Taxation of Foreign Source Income
The State Taxation of GILTI
State Corporate Income Tax Conformity to GILTI*

* Based generally on 80% or more direct corporate ownership of foreign corporations. Other rules may apply for smaller % ownership or state personal income tax (PIT) purposes.

** GILTI is not specifically referenced in many state conformity statutes so some states may still decouple from some or all of GILTI by administrative/legislative action.


Source: Council On State Taxation

Disclaimer: This information should be used for general guidance and not relied upon for compliance.

Note: Those states with “less §250 deduction” only tax 50% of GILTI (or 62.5% after 2025).
Is the Impact of GILTI the Same for State Tax Purposes as for Federal Tax Purposes?

— **Global (same):** The starting point of federal and state GILTI (global intangible low-taxed income) is generally all of the global income earned by the taxpayer’s foreign subsidiaries (after subtracting a 10 percent return on foreign fixed assets).
Is the Impact of GILTI the Same for State Tax Purposes as for Federal Tax Purposes?

— **Not Limited to Intangibles (same):** GILTI includes income from services, digital products, financial services, a sizable portion of tangible property sales, and intangibles.
Is the Impact of GILTI the Same for State Tax Purposes as for Federal Tax Purposes?

— **Low-Taxed (different):** The states do not conform to the (80%) foreign tax credit allowed for federal tax purposes to offset the GILTI income and limit the impact to “low-taxed” income.

— Counterpoint – Do they need to?
Is the Impact of GILTI the Same for State Tax Purposes as It Is for Federal Tax Purposes?

— **Offset by Corporate Tax Cuts (different):** The states do not conform to federal corporate tax cuts (Congress is raising $324 billion over 10 years from the international tax provisions to help pay for $654 billion in business tax cuts).

— **Counterpoint – Do states need to lower rates?**
Is the Impact of GILTI the Same for State Tax Purposes as It Is for Federal Tax Purposes?

— Domestic Commerce vs. Foreign Commerce *(different)*: The states are limited by the Constitution’s Commerce Clause and cannot treat foreign commerce differently than domestic commerce.
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

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What About Foreign Derived Intangible Income (FDII)?

**General Overview:** I.R.C. Section 250 provides a 37.5% deduction (decreased to 21.875% after 2025) for certain income earned by a U.S. domestic corporation attributed to foreign sales relating to U.S. production.

- Results in a reduced federal effective tax rate on covered income of 13.125%, subject to a taxable income limitation (16.40625% after 2025).
- FDII is calculated in a manner similar to GILTI. Returns in excess of 10% of fixed assets form the basis for the calculation (and deduction). Conformity may depend on whether a state’s starting point for calculation of state taxable income is Form 1120 line 28 or line 30.
- FDII is somewhat akin to a “patent-box” regime used by some European countries to provide a favorable tax regime for intangibles located in the jurisdiction.

**State Tax Issues:**

- Modest State Conformity – approximately one dozen states have conformed to FDII.
  - Selective decoupling – FDII, as enacted, is designed to work with GILTI.
- The impact of FDII will be affected by a taxpayer’s state income tax filing method.
- Do states need to adopt any special apportionment formula for FDII?
Factor Representation and Constitutional Issues Relating to State Taxation of Foreign Source Income
—While most of the attention has been focused on state-by-state conformity to or decoupling from GILTI, a less noticed trend has developed regarding state guidance on the other key element of the state income tax equation: apportionment.
Factor Representation: GILTI and IRC §965 Repatriated Income

— The apportionment methodologies available to the states include:
  • No factor representation.
  • No specific guidance which can result in a taxpayer using its “domestic” factors to apportion GILTI/965 income or including its net GILTI/965 income in the denominator.
  • Net GILTI/ Section 965 income in the denominator.
  • Gross Receipts that produced the GILTI/ Section 965 income in the denominator.
  • Other
    • For example, New Jersey initially adopted a unique apportionment methodology for GILTI and FDII based on the state’s share of US GDP. The formula did not allow inclusion of foreign factors nor of any other factors relating to the taxpayer’s business activity in the state. New Jersey revised its methodology in August 2019 to allow taxpayers to include net GILTI in the denominator.
To date, the vast majority of the states provide no guidance on how to apportion GILTI/ Section 965 income or allow only the net taxable foreign source income, and not the gross receipts (or other factors) to be included in the denominators of the respective factors.
GILTI State Factor Representation*

- State does not impose a corporate income tax
- The state currently does not impose its corporate income tax on GILTI
- No factor representation allowed
- No new guidance
- Other methodology
- Sales factor denominator only includes net GILTI (after Sec. 250 or other deduction)
- Foreign factors (including gross receipts) relating to taxable income allowed in denominator(s)

Pattern indicates unofficial state positions (in appropriate colors)

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Future Litigation over State Taxation of GILTI and IRC §965
Repatriated income

— Separate reporting states: Can the foreign source income be taxed at all?

• See *Kraft General Foods Inc. v. Iowa Department of Revenue*, 505 U.S. 71 (1992). A separate reporting state may not tax dividends from a controlled foreign corporation if it does not tax dividends from a controlled domestic corporation.

• Five separate reporting states (plus NJ in 2018) are still coupled to GILTI
Future Litigation over State Taxation of GILTI and IRC §965 Repatriated income

- **Combined reporting states: Can the foreign source income be taxed without appropriate factor representation (or a unitary relationship)?**

  • Does the state taxation of GILTI (and IRC §965 Repatriated income) in combined reporting states violate Commerce Clause limitations unless appropriate foreign “factor representation” is allowed.

  • Is GILTI in part “displaced domestic income”? If so, does that change the apportionment requirements?

  • This is not a new issue – the same issue arose in connection with how states apportion income from foreign dividends.

Future Direction of State Taxation of Foreign Source Income
European Proposals to Address Base Erosion/ Profit Shifting and to Tax Digital Companies

• The OECD BEPS Report in 2015

• The French legislation to impose a 3 percent gross-receipts-like tax on companies with annual global revenue of more than 750 million euros providing digital services.

• The OECD 2019 “Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy”.
  • New profit allocations rules
  • New nexus rules.
  • GILTI or BEAT-like proposals.

• It’s a Small World (after all): the cross-fertilization of state, federal and international tax concepts
Should Subnational Corporate Income Taxes Be Imposed on Foreign Source Income?

- **49 nations** (including the United States) are members of the Organization of Economic Cooperation and Development (OECD) and/or the Group of 20.
- Together these advanced industrialized countries account for well over 90 percent of world economic production.
- Only **eight** of these nations (in addition to the United States) impose corporate income taxes at the subnational level (e.g. state/province or municipality).
- Only **one** of the eight nations outside the United States that have corporate income taxes at the subnational level include foreign source income in the subnational tax base (Korea).
- Should states impose a corporate income tax on foreign source income when virtually no other industrialized nations in the world do so at the subnational government level?
Future Direction of State Taxation of Foreign Source Income

- Will more/fewer states tax GILTI?
- Will any state adopt BEAT?
- Will additional states enact “tax haven” legislation?
- Will any state enact legislation mandating worldwide combined reporting?
- Will states expand transfer pricing capabilities?
- Will any states follow the lead of France and impose a gross receipts-like tax on digital companies?
QUESTIONS?

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